

VETS REVENUE 12-10-97

NEW ISSUE—BOOK-ENTRY ONLY

In the opinion of The Honorable Daniel E. Lungren, Attorney General of the State of California ("Attorney General"), and Hawkins, Delafield & Wood ("Bond Counsel"), assuming compliance by the Department with certain tax covenants described herein, the interest on the Offered Revenue Bonds is not included in gross income for federal income tax purposes under existing statutes and court decisions, and the interest on the Offered Revenue Bonds is exempt from personal income taxes of the State of California under present State law. The Attorney General and Bond Counsel are of the opinion that (i) the interest on the 1997 Series A Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Internal Revenue Code of 1986, as amended (the "Tax Code"), with respect to individuals and corporations; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations; and (ii) interest on the 1997 Series B Bonds, 1997 Series C Bonds, and 1998 Series A Bonds will be treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Tax Code with respect to individuals and corporations. See "TAX MATTERS" herein.



\$275,055,000
Department of Veterans Affairs
of the State of California
Home Purchase Revenue Bonds
\$10,805,000 1997 Series A (NON-AMT)
\$ 10,185,000 1997 Series B (AMT)
\$100,000,000 1997 Series C (AMT)
\$154,065,000 1998 Series A (AMT)

Dated: As shown on inside front cover page

Due or Subject to Mandatory Tender: As shown on inside front cover page

The 1997 Series A Bonds, the 1997 Series B Bonds, the 1997 Series C Bonds, and the 1998 Series A Bonds referred to above (collectively, the "Offered Revenue Bonds") will be issued as fully-registered bonds in denominations of \$5,000 or any integral multiple thereof.

When executed and delivered, the Offered Revenue Bonds will be initially registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository of the Offered Revenue Bonds. Beneficial owners of the Offered Revenue Bonds will not receive physical certificates representing their interests in the Offered Revenue Bonds purchased. So long as the DTC book-entry method is used for the Offered Revenue Bonds, principal, premium, if any, and interest due with respect to the Offered Revenue Bonds will be paid by the Treasurer of the State of California, as Trustee (the "Trustee"), to DTC or its nominee. The Treasurer of the State of California is also Agent for Sale with respect to the Offered Revenue Bonds.

Interest on the 1997 Series A Bonds, the 1997 Series B Bonds, and the 1998 Series A Bonds is payable on June 1 and December 1 of each year, commencing June 1, 1998 for the 1997 Series A Bonds and 1997 Series B Bonds, and December 1, 1998 for the 1998 Series A Bonds. The 1997 Series A Bonds, the 1997 Series B Bonds and the 1998 Series A Bonds are subject to redemption prior to maturity, including redemption at par, as described herein.

The 1997 Series C Bonds will bear interest, payable on June 1 and December 1 of each year, commencing June 1, 1998, and on the applicable Mandatory Tender Date, from their dated date at the rate and will be subject to mandatory tender (with no right to retain) on the applicable Mandatory Tender Date, as shown on the inside front cover page. **This Official Statement is not intended to provide any information with respect to any 1997 Series C Bond after its applicable Mandatory Tender Date.** The 1997 Series C Bonds are subject to redemption at par, in whole or in part, on the applicable Mandatory Tender Date or on any date that could be designated as the Mandatory Tender Date, as described herein.

Payments of the principal of and interest on the 1998 Series A Bonds when due will be insured by a municipal bond insurance policy to be issued by Ambac Assurance Corporation simultaneously with the delivery of the 1998 Series A Bonds. See "THE 1998 SERIES A MUNICIPAL BOND INSURANCE POLICY."

The Offered Revenue Bonds are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund") (other than proceeds of Veterans G.O. Bonds, as defined herein, and amounts in any Rebate Account), (ii) the Bond Reserve Account, and (iii) the Loan Loss Account. The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of Veterans G.O. Bonds under any general obligation veterans bond act. The Department has no taxing power. Neither the faith and credit nor the taxing power of the State of California or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.

The Offered Revenue Bonds are offered when, as and if issued and delivered to the Underwriters and are subject to the approval of legality by The Honorable Daniel E. Lungren, Attorney General of the State of California, and by Hawkins, Delafield & Wood, Bond Counsel. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock. It is expected that the Offered Revenue Bonds in book-entry form will be available for delivery at the offices of DTC on or about December 29, 1997 for the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds, and on or about May 5, 1998 for the 1998 Series A Bonds.

Honorable Matt Fong
Treasurer of the State of California

J. C. Bradford & Co.
Great Pacific Securities, Inc.
J.P. Morgan & Co.

Bear, Stearns & Co. Inc.
E. J. De La Rosa & Co., Inc.
Lehman Brothers
John Nuveen & Co.
Incorporated
Samuel A. Ramirez & Co., Inc.

Goldman, Sachs & Co.
Merrill Lynch & Co.
PaineWebber Incorporated

MATURITY SCHEDULE

\$10,805,000 1997 Series A Bonds (NON-AMT)—Dated: December 1, 1997

**\$10,805,000 5.40% 1997 Series A Term Bonds due December 1, 2028 CUSIP No. 130658FR3
(plus accrued interest)**

\$10,185,000 1997 Series B Bonds (AMT)—Dated: December 1, 1997

\$3,735,000 1997 Series B Serial Bonds

<u>Due (Dec. 1)</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>CUSIP Number</u>	<u>Due (Dec.1)</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>CUSIP Number</u>
1998	\$235,000	3.85%	130658FS1	2004	\$355,000	4.55%	130658FY8
1999	255,000	4.00	130658FT9	2005	380,000	4.60	130658FZ5
2000	275,000	4.15	130658FU6	2006	405,000	4.70	130658GA9
2001	295,000	4¼	130658FV4	2007	430,000	4.80	130658GB7
2002	315,000	4.35	130658FW2	2008	455,000	4.90	130658GC5
2003	335,000	4.45	130658FX0				

**\$6,450,000 5½% 1997 Series B Term Bonds due December 1, 2018 CUSIP No. 130658GD3
(plus accrued interest)**

\$100,000,000 1997 Series C Bonds (AMT)—Dated: Date of Delivery

1997 Series C Term Bonds due December 1, 2019 CUSIP No. 130658GE1

4.20%, with respect to each 1997 Series C Bond, to and including the day preceding its Mandatory Tender Date. All or any portion of the 1997 Series C Bonds is subject to mandatory tender **(with no right to retain)** on a Mandatory Tender Date. The Mandatory Tender Date for any 1997 Series C Bond is December 1, 1999, *unless* the Department designates one or more business days prior thereto on or after December 1, 1998 as the Mandatory Tender Date for all or any portion of the 1997 Series C Bonds. Individual 1997 Series C Bonds may have different Mandatory Tender Dates.

\$154,065,000 1998 Series A Bonds (AMT)—Dated: Date of Delivery

\$69,500,000 4.90% 1998 Series A Term Bonds due December 1, 2018 CUSIP No. 130658GF8

\$84,565,000 5.45% 1998 Series A Term Bonds due December 1, 2019 CUSIP No. 130658GG6

Price of all Offered Revenue Bonds: 100%

STATE OF CALIFORNIA

Pete Wilson — Governor

DEPARTMENT OF VETERANS AFFAIRS

Col. Jay R. Vargas, USMC (RET)	—	Secretary
Lee Bennett	—	Undersecretary
Leon Tuttle	—	Deputy Secretary, Operations
Loren Suter	—	Deputy Secretary, Administration
Craig Stevenson	—	Chief Counsel
Delores A. McKinnon	—	Chief, Bond Finance Division
Mike Madalo	—	Chief, Farm and Home Purchases Division

VETERANS' DEBENTURE FINANCE COMMITTEE

Pete Wilson	—	Governor
Matt Fong	—	State Treasurer
Kathleen Connell	—	State Controller
Craig L. Brown	—	Director of Finance
Col. Jay R. Vargas, USMC (RET)	—	Secretary of Veterans Affairs

CALIFORNIA VETERANS BOARD

Leo P. Burke	—	Chairman
Robert D. Dolman		George A. Maness
Ronald H. Markarian		Bennett S. Sparks
Doris K. Winter		Col. Jay R. Vargas, USMC (RET)

CALIFORNIA STATE TREASURER'S OFFICE

Matt Fong	—	State Treasurer (as Trustee and as Agent for Sale)
-----------	---	---

ATTORNEY GENERAL OF THE STATE OF CALIFORNIA

Daniel E. Lungren	—	Attorney General
Dave Stirling	—	Chief Deputy Attorney General

BOND COUNSEL

Hawkins, Delafield & Wood

QUANTITATIVE CONSULTANTS

cfX Incorporated

INDEPENDENT AUDITOR

Deloitte & Touche LLP

(THIS PAGE INTENTIONALLY LEFT BLANK)

No dealer, broker, salesman or other person has been authorized by the Department of Veterans Affairs or the Underwriters to give any information or to make any representations with respect to the Department of Veterans Affairs or its Offered Revenue Bonds other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources which are believed to be current and reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Department of Veterans Affairs since the date hereof.

TABLE OF CONTENTS

	<u>Page</u>		<u>Page</u>
INTRODUCTION	1	Contracts of Purchase	34
PLAN OF FINANCE AND		Loan Insurance	37
PROGRAMMATIC CHANGES	3	Property and Life and Disability Insurance ...	38
Plan of Finance	3	SUMMARY OF CERTAIN PROVISIONS OF	
Programmatic Changes	4	THE RESOLUTION	40
THE DEPARTMENT	5	TAX MATTERS	71
General	5	Federal Tax Matters	71
Administration	5	State Tax Matters	77
SECURITY FOR AND SOURCES OF		VERIFICATION OF MATHEMATICAL	
PAYMENT OF THE REVENUE BONDS ...	8	ACCURACY OF CERTAIN	
General	8	COMPUTATIONS WITH RESPECT TO	
The 1943 Fund	8	THE PRIOR REVENUE BONDS.....	77
Bond Reserve Account	9	LITIGATION	78
Loan Loss Account	10	UNDERWRITING	79
Cash Flow Statements and Program Operating		CERTAIN LEGAL MATTERS	79
Procedures	10	FINANCIAL STATEMENTS	79
Cash Flow Statement to be Delivered		LEGALITY FOR INVESTMENT	79
in Connection with the Offered		RATINGS	79
Revenue Bonds	12	CONTINUING DISCLOSURE	80
Maintenance of Fund Parity	13	MISCELLANEOUS	81
Additional Revenue Bonds	14	EXHIBIT A — FINANCIAL STATEMENTS	
THE 1998 SERIES A MUNICIPAL BOND		OF THE 1943 FUND FOR FISCAL YEARS	
INSURANCE POLICY	14	1996 AND 1997 AND INDEPENDENT	
SELECTED FINANCIAL DATA OF THE		AUDITOR'S REPORT.....	A-1
1943 FUND AND DEPARTMENT'S		EXHIBIT B — MANDATORY SINKING	
DISCUSSION	18	ACCOUNT PAYMENTS	B-1
Selected Financial Data of the 1943 Fund....	18	EXHIBIT C — SUMMARY OF CERTAIN	
Department's Discussion of Financial Data....	20	PROVISIONS OF THE MASTER	
THE OFFERED REVENUE BONDS	22	CONTINUING DISCLOSURE	
General	22	UNDERTAKING	C-1
Redemption	22	EXHIBIT D — CERTAIN DEPARTMENT	
Mandatory Tender of 1997 Series C Bonds ...	27	FINANCIAL INFORMATION AND	
BOOK-ENTRY ONLY SYSTEM	28	OPERATING DATA	D-1
APPLICATION OF OFFERED REVENUE		EXHIBIT E — PROPOSED FORMS OF	
BOND PROCEEDS	31	OPINION OF ATTORNEY GENERAL	
THE PROGRAM	31	AND BOND COUNSEL	E-1
Qualifying Veteran Status	32	EXHIBIT F — FORM OF 1998 SERIES A	
Administration of the Farm and Home		MUNICIPAL BOND INSURANCE POLICY	F-1
Purchase Program	33		

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE OFFERED REVENUE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

(This page intentionally left blank)

**Official Statement
of
Department of Veterans Affairs
of the State of California
Relating to
\$275,055,000
Home Purchase Revenue Bonds**

**\$10,805,000 1997 Series A (NON-AMT)
\$10,185,000 1997 Series B (AMT)
\$100,000,000 1997 Series C (AMT)
\$154,065,000 1998 Series A (AMT)**

INTRODUCTION

This Official Statement (which includes the cover page, the inside cover page and the Exhibits hereto) is being furnished to provide information in connection with the sale of the Department of Veterans Affairs of the State of California (the "Department") Home Purchase Revenue Bonds, 1997 Series A (the "1997 Series A Bonds"), Home Purchase Revenue Bonds, 1997 Series B (the "1997 Series B Bonds"), Home Purchase Revenue Bonds, 1997 Series C (the "1997 Series C Bonds"), and Home Purchase Revenue Bonds, 1998 Series A (the "1998 Series A Bonds") (collectively, the "Offered Revenue Bonds"). The Offered Revenue Bonds are being issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended (the "Act"), constituting Chapter 7 of Division 4 of the Military and Veterans Code (the "Veterans Code") of the State of California (the "State"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), and (4) the Ninth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$294,430,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A, adopted November 24, 1997 and expected to be amended December 22, 1997 (the "Ninth Supplemental Resolution"). The Resolution of Issuance, as amended and supplemented by the Eighth Supplemental Resolution, and the Ninth Supplemental Resolution are collectively referred to herein as the "Resolution."

The 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds are expected to be issued on December 29, 1997, while the 1998 Series A Bonds are expected to be issued on May 5, 1998. It is a condition to the issuance of the 1998 Series A Bonds that the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds have been issued. Each 1997 Series C Bond will bear interest at a short term rate to its Mandatory Tender Date, at which time its interest rate can be adjusted to a long term fixed rate to its maturity or prior redemption, or to a new short term rate until a new mandatory tender date. The 1997 Series C Bonds are subject to mandatory tender (with no right to retain) on the applicable Mandatory Tender Date set forth on the inside front cover page. **This Official Statement is not intended to provide any information with respect to any 1997 Series C Bond after its applicable Mandatory Tender Date.** See "THE OFFERED REVENUE BONDS—Mandatory Tender of 1997 Series C Bonds."

Ambac Assurance Corporation (the "Insurer") has made a commitment to issue an insurance policy (the "1998 Series A Municipal Bond Insurance Policy") with respect to the 1998 Series A Bonds, a copy of the form of which is attached as Exhibit F. The 1998 Series A Municipal Bond

Insurance Policy is not a source of payment for and does not provide security for any Revenue Bonds other than the 1998 Series A Bonds. See "THE 1998 SERIES A MUNICIPAL BOND INSURANCE POLICY."

The Department has issued a number of series of bonds under the Resolution of Issuance, of which three series remain outstanding as of the date of this Official Statement (the "Prior Revenue Bonds"), and has applied the proceeds of the Prior Revenue Bonds to finance home ownership for eligible veterans in the State. Upon issuance of the 1997 Series A Bonds, the 1997 Series B Bonds, and the 1997 Series C Bonds, all of the remaining Prior Revenue Bonds will be retired or defeased, so that there will be no outstanding Prior Revenue Bonds. The Offered Revenue Bonds and bonds of any additional series issued under the Resolution of Issuance ("Additional Revenue Bonds") are secured on a parity basis and are hereinafter collectively called the "Revenue Bonds."

The effect of the Eighth Supplemental Resolution is a complete replacement of the provisions of the original Resolution of Issuance. These new provisions include changes to the security and the administrative provisions which had been applicable to the Prior Revenue Bonds. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS" and "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION."

The Revenue Bonds, including the Offered Revenue Bonds, are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund") other than proceeds of Veterans G.O. Bonds (defined below) and any amounts in any Rebate Account, (ii) the Bond Reserve Account, and (iii) the Loan Loss Account. The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of veterans general obligation bonds issued by the Department under any and all present and future veterans general obligation bond acts (collectively the "Veterans G.O. Bonds"). See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS." **The Department has no taxing power. Neither the faith and credit nor the taxing power of the State of California or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.**

Concurrently with the offering, sale and issuance of the Offered Revenue Bonds, the Department plans to offer, sell and issue an aggregate principal amount of up to \$1,166,970,000 of Veterans G.O. Bonds (the "1997 Veterans G.O. Bonds") in order to refund other outstanding Veterans G.O. Bonds and to finance new Contracts of Purchase. The Offered Revenue Bonds and the 1997 Veterans G.O. Bonds are separate bond issues, although they are treated as a single issue for certain federal tax purposes. The sales and issuances of the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds are not interdependent. The 1997 Veterans G.O. Bonds will be offered and sold pursuant to a separate official statement, copies of which may be obtained from the State Treasurer's Office, P.O. Box 942809, Sacramento, CA 94209-0001, telephone (916) 653-3451. See "PLAN OF FINANCE AND PROGRAMMATIC CHANGES."

A portion of the proceeds of the Offered Revenue Bonds is to be used to retire a portion of the outstanding Prior Revenue Bonds. The balance of the proceeds of the Offered Revenue Bonds, after certain reallocations have been made for federal tax purposes, will be used to finance new Contracts of Purchase. Proceeds attributable to the 1997 Series C Bonds will become available for new Contracts of Purchase when and to the extent that the short term interest rate thereon is adjusted to fixed interest rates to maturity or prior redemption. The Department will use other moneys, some of which will become available as a result of the retirement of Prior Revenue Bonds, to effect the defeasance of the remaining Prior Revenue Bonds, so that none will be outstanding following issuance of the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds.

Upon the retirement or defeasance of the Prior Revenue Bonds, certain of the Contracts of Purchase financed by such bonds will be allocated to the Offered Revenue Bonds. The Department will pay all expenses with respect to the issuance of the Offered Revenue Bonds from moneys available in the 1943 Fund. See "PLAN OF FINANCE AND PROGRAMMATIC CHANGES."

Under the Department's Farm and Home Purchase Program (the "Program"), the Department acquires residential property to be sold to eligible veterans under contracts of purchase between the Department and such veterans ("Contracts of Purchase"). Such acquisition is financed principally with the proceeds of bonds, including Veterans G.O. Bonds and revenue bonds (in the past, Prior Revenue Bonds, and in the future, Revenue Bonds). Contracts of Purchase ("Prior Revenue Bonds Contracts of Purchase") were entered into with respect to properties purchased by the Department with the proceeds of the Prior Revenue Bonds.

The respective issuances of the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds are for the purposes of restructuring the Department's outstanding debt and further implementing of the Program. This restructuring is discussed in greater detail under "PLAN OF FINANCE AND PROGRAMMATIC CHANGES" and "THE PROGRAM."

All capitalized terms used in this Official Statement and not defined herein shall have the meanings set forth in the Resolution. See "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION—Definitions (Section 103)."

PLAN OF FINANCE AND PROGRAMMATIC CHANGES

Plan of Finance

The Department has developed the financing plan described under this subheading to lower the cost of the outstanding indebtedness which financed the existing Contracts of Purchase and the funds currently available to finance new Contracts of Purchase, and to make additional funds available to finance new Contracts of Purchase. The Department expects to apply substantially all of its debt service cost savings to reduce the interest rate on certain existing Contracts of Purchase. The issuance of the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds and the application of certain available moneys are expected to result in the retirement (including payment at maturity) or defeasance of all of the outstanding Prior Revenue Bonds and certain of the existing Veterans G.O. Bonds as follows:

<u>Prior Revenue Bonds</u>		<u>Veterans G.O. Bonds</u>
\$107,600,000 1986 Series A	\$ 4,800,000 Series QQ	\$ 42,000,000 Series AX
\$156,650,000 1988 Series A	\$ 4,800,000 Series UU	\$198,500,000 Series AY
\$ 30,180,000 1991 Series A	\$ 1,500,000 Series AK	\$ 51,000,000 Series AZ
	\$ 6,000,000 Series AL	\$205,700,000 Series BA
	\$ 1,000,000 Series AN	\$ 7,710,000 Series BD
	\$ 500,000 Series AP	\$ 13,810,000 Series BE
	\$ 12,370,000 Series AT	\$ 15,265,000 Series BF
	\$271,615,000 Series AW	

See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Retirement or defeasance of the Prior Revenue Bonds will allow for the effectuation of the substantial amendments and supplements to the Resolution of Issuance by the Eighth Supplemental Resolution to take effect on the date of issuance of the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds. See "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION."

The issuances of the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds and certain federal tax-related reallocations, are expected to result in moneys becoming available for new Contracts of Purchase. Certain of such moneys relate to the 1997 Series A Bonds, 1997 Series B Bonds, and 1998 Series A Bonds and certain of the Veterans G.O. Bonds designated Series BH, and will become available when such bonds are issued. Certain of such moneys represent proceeds of the 1997 Series C Bonds and the 1997 Veterans G.O. Bonds designated Series BJ, all of which have been issued as convertible option bonds bearing short term interest rates to their mandatory tender dates. These moneys will become available to finance new Contracts of Purchase when and if the interest rates on such bonds are adjusted to fixed interest rates to their respective maturities or prior redemption. See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Contracts of Purchase—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments." In addition, the Contracts of Purchase financed by the retired bonds will be reallocated to the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds, as applicable.

As part of the overall plan of finance, approximately \$160 million of Veterans G.O. Bonds are expected to be issued on or about March 1998 (the "1998 Veterans G.O. Bonds") in order to refund certain additional outstanding Veterans G.O. Bonds.

Programmatic Changes

The Department has completed or has in progress a number of significant changes to the Program. The Department's principal goals have been to lower the interest rate on existing Contracts of Purchase, provide an interest rate on new Contracts of Purchase which more closely reflects its borrowing costs, better service Contracts of Purchase to reduce real estate losses, obtain mortgage insurance or guaranty to reduce exposure to future real estate losses, and revamp the various insurance products the Department offers to veterans with Contracts of Purchase.

The Veterans Code currently requires that all Contracts of Purchase bear a uniform interest rate which is subject to periodic adjustment. (There are statutory exceptions to the uniform rate requirement but the impact of these exceptions on the Program is *de minimis*.) The Department intends to seek legislative changes to eliminate the uniform rate and periodic adjustment requirements. This will allow the Department to offer fixed interest rates on future Contracts of Purchase which more closely reflect its costs of borrowing. Until such legislative changes are made, the New 1997/1998 Revenue Bonds Contracts of Purchase (as defined herein under "TAX MATTERS") will be originated under the current statutory provisions.

The current uniform interest rate on approximately 98% of the existing Contracts of Purchase is 8.0% per annum. The current high interest rate has reduced demand for new Contracts of Purchase. The plan of finance described herein is expected to enable the Department to lower the interest rate on existing Contracts of Purchase. Legislation effective January 1, 1998 has expanded veteran eligibility under State law to include Peacetime Veterans (defined below under "THE PROGRAM—Qualifying Veteran Status—Veterans Code"). The Department expects that this eligibility expansion, coupled with expected lowered interest rates on Contracts of Purchase, will increase Program demand.

The Department has undertaken a series of steps designed to address real estate losses and loss exposure. It has reorganized its loan servicing, and begun updating its automated loan accounting and servicing functions. It has set aside additional reserves for loan losses. It also expects to obtain primary mortgage insurance (with a deductible) for a portion of the existing Contracts of Purchase with high loan-to-value ratios, and loan guarantees from the United States Department of Veterans Affairs ("USDVA") for most new Contracts of Purchase with high loan-to-value ratios.

There can be no assurance that the Department will be able to obtain the legislative changes it seeks or will obtain mortgage insurance or guaranties on terms and prices acceptable to the Department.

The Veterans Code and/or long-standing Department policies have called for the Department to provide casualty and life and disability insurance for veterans with Contracts of Purchase. During the period that the Department self-insured this liability, the Department experienced significant losses. Over the past few years it has undertaken significant steps to reduce its losses, including obtaining outside providers for some portions of these various types of insurance.

Additional information regarding the Department's programmatic changes is set forth under "THE PROGRAM." For additional discussion of qualifying veterans and interest rates on Contracts of Purchase, see, respectively, "THE PROGRAM—Qualifying Veteran Status" and "—Contracts of Purchase." For additional discussion of real estate losses, see "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION" and "THE PROGRAM—Loan Insurance." For additional discussion of the Department's insurance programs, see "THE PROGRAM—Property and Life and Disability Insurance."

• THE DEPARTMENT

General

In 1921 the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to afford eligible veterans the opportunity of acquiring homes with long-term low-interest financing provided under the Program.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. No moneys generated by the Program may be used for any purpose other than providing farm, home and mobile home financing to veterans under the Program, paying debt service on Veterans G.O. Bonds and on the Revenue Bonds, financing home and property improvements for properties which have been financed under the Program, and paying costs associated with the administration of the Program.

Administration

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members: the Secretary of Veterans Affairs and six public members appointed by the Governor of the State for respective terms of four years. All of the members of the Board must be veterans, and membership is subject to confirmation by the State Senate. One of these members must be retired from the active or reserve forces of the United States military service. The present members of the Board are set forth on an introductory page of this Official Statement.

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for the collection and evaluation of data regarding applicants for the Program and the property to be acquired under the Program. This includes an examination as to the qualification of veterans to participate in the Program, a credit analysis, an appraisal of properties and the initial processing of the veteran's application for a Contract of Purchase.

Loan origination and servicing of the Contracts of Purchase are performed by the Department at its headquarters, and entail mortgage loan accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of September 30, 1997, the Department's Farm and Home Purchase Division had a staff of 146 persons.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor, and must be a veteran.

Colonel Jay R. Vargas, USMC (RET)
Secretary since June 1993

Secretary Vargas retired from the United States Marine Corps with the rank of Colonel after a distinguished 31-year career. In 1970 he received our nation's highest military honor when, in a White House ceremony conducted by President Richard Nixon, he was awarded the Congressional Medal of Honor. He commanded Marines at every level from Rifle Platoon to Infantry Regiment. His final tour of military duty was as Force Marine on the staff of Commander, U.S. Forces, Pacific.

Secretary Vargas attended Arizona State University and earned the degree of Bachelor of Science in Education. During his career as a Marine officer, he continued his education and earned the degree of Master of Arts in Education from the United States International University in San Diego, California, and graduated from the Marine Corps Command and Staff College and the Naval War College. In addition to the Medal of Honor, Secretary Vargas is the recipient of numerous military decorations, and has been honored by the American Academy of Achievement with its "Gold Plate Award."

Lee Bennett
Undersecretary since October 1995

On October 2, 1995, Governor Pete Wilson appointed Lee Bennett as the Undersecretary of the Department. A U.S. Navy veteran, Mr. Bennett was employed by the California Legislature for 29 years prior to his appointment. He graduated from California State University, Sacramento ("CSUS"), in 1970 with a Bachelor of Arts in Social Science and, in 1976, he received a Master of Arts in Behavioral Sciences from CSUS.

As a legislative employee, Mr. Bennett served in a number of key positions in both houses of the Legislature. Most recently, he served as the Senate Rules Committee consultant and staff director for Senator Robert G. Beverly. Prior to that, he was staff director for the Senate Republican Fiscal Consultants where his principal responsibility involved the development of the annual budget act and the review of bills assigned to the Senate Appropriations Committee. A credentialed teacher, he has also taught evening adult education classes in American Government.

Leon Tuttle
Deputy Secretary, Operations since September 1995

Mr. Tuttle graduated from the University of Wyoming and holds Master's Degrees in Business from Michigan State University and the University of Southern California. He is also a certified public accountant. He served on active duty in the U.S. Air Force from 1956 until 1980, when he retired with the rank of Colonel. During his service career, he served in flying operations jobs and, in the latter years of his service, held positions in budgeting, auditing and accounting. His last

assignment was as Director of Plans and Systems at the Air Force Accounting and Finance Center in Denver, Colorado. Since completing his service career, he has worked in senior financial management positions in both private industry and state government.

Loren Suter

Deputy Secretary, Administration since August 1995

On August 28, 1995, Colonel Jay R. Vargas appointed Mr. Suter to the Chief, Finance Division position. This position was elevated to Deputy Secretary, Administration on March 4, 1996. Mr. Suter has been with the State of California in various finance and social service program executive positions for the past eighteen years. He was also in various finance staff positions for ten years. In 1968, Mr. Suter graduated from California State University-Sacramento with a Bachelor of Science Degree in Accounting.

Mike Madalo

Chief, Farm and Home Purchases Division since April 1997

Mr. Madalo was appointed as Chief of the Farm and Home Purchases Division on April 1, 1997. He graduated in 1962 from the U.S. Naval Academy, Annapolis, Maryland, and holds a Bachelor of Science degree in Engineering. He served on active duty in the United States Marine Corps from 1962 to 1966 as a fighter bomber pilot in Vietnam. Mr. Madalo held positions, including Plant Manager, General Manager, and Marketing Manager, with the American Cyanamid Company. He was Vice President in charge of Operations for LAMAU, Inc., in Minneapolis, Minnesota; President/Owner of Empire Aire Aviation, Inc., in Fresno, California; President of Sun Laboratories of Atlanta, Inc., in Atlanta, Georgia; and Owner/President of PMI Consulting, in Fair Oaks, California.

Delores A. McKinnon

Chief, Bond Finance Division since December 1994

Ms. McKinnon is a graduate of Revelle College at the University of California, San Diego. From 1973 to 1981 she served as a research analyst, budget analyst and Assistant Budget Officer for the Department of Social Services. At the State Treasurer's Office from 1981 to 1984, she was a security trader and credit analyst for the State's Pooled Money Investment Account. From 1984 to December 1994, Ms. McKinnon held a variety of financial management positions with the State Treasurer's Office, including overseeing the sale and issuance of State bonds and trustee, paying agent and securities clearance services provided by such office.

Craig Stevenson

Chief Counsel since September 1996

Mr. Stevenson is a graduate of the University of California at Berkeley and the University of California at Davis School of Law. He served on active duty for three years in the U.S. Army Judge Advocate General Corps., followed by over twenty years' service in the California National Guard, from which he retired in 1996 with the grade of lieutenant colonel.

Mr. Stevenson was employed in Glenn County, California as the Assistant District Attorney for seven years and then was elected District Attorney for two terms. He entered private practice for almost four years and then worked at the Department of Motor Vehicles from October, 1994 until 1996.

SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS

General

The Offered Revenue Bonds are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the 1943 Fund other than proceeds of Veterans G.O. Bonds and any amounts in any Rebate Account, (ii) the Bond Reserve Account, and (iii) the Loan Loss Account. **State law provides that such undivided interest in the assets of the 1943 Fund is secondary and subordinate to the obligation of the 1943 Fund to pay or reimburse debt service on the Veterans G.O. Bonds, as described below. The Department has no taxing power. Neither the faith and credit nor the taxing power of the State of California or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.**

The 1998 Series A Bonds are the subject of the 1998 Series A Municipal Bond Insurance Policy, as described below. The Resolution does not require that Revenue Bonds be the subject of a bond insurance policy or other form of credit enhancement. See "THE 1998 SERIES A MUNICIPAL BOND INSURANCE POLICY."

The 1943 Fund

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) the proceeds of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest and any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds.

In addition to payment or reimbursement of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described below under "THE PROGRAM—Property and Life and Disability Insurance."

The Program has experienced significant losses during the last five fiscal years, which have caused decreases in the retained earnings in the 1943 Fund. For additional information, see below "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION" and also see Exhibit A—"FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 1996 AND 1997 AND INDEPENDENT AUDITOR'S REPORT."

The Act and the Veterans Code provide that the undivided interest created by the Resolution in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the State Treasury (the "State General Fund") in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). If amounts in the 1943 Fund are insufficient for such purposes, the State General Fund will pay debt service on Veterans G.O. Bonds. The balance remaining unpaid must be transferred to the State General Fund out of the 1943 Fund as soon thereafter as it becomes

available, together with interest thereon at the rate borne by the Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the State General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund, however, do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of September 30, 1997, there were outstanding \$2,595,595,000 aggregate principal amount of Veterans G.O. Bonds and \$294,430,000 aggregate principal amount of Prior Revenue Bonds. As of September 30, 1997, \$654,370,000 of Veterans G.O. Bonds have been authorized but not issued, and the Department may in the future seek voter approval for additional amounts. The proposed 1997 Veterans G.O. Bonds will utilize part of such \$654,370,000 authorized amount. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be Outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then Outstanding. See "PLAN OF FINANCE AND PROGRAMMATIC CHANGES" for information about the issuance of the 1997 Veterans G.O. Bonds and the Offered Revenue Bonds and the retirement of outstanding Veterans G.O. Bonds and the Prior Revenue Bonds. Additional information about outstanding Veterans G.O. Bonds and the Prior Revenue Bonds is in Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Veterans G.O. Bonds and Prior Revenue Bonds."

Current provisions of the Veterans Code require that the interest rate on all Contracts of Purchase (except certain *de minimis* exceptions) be uniform and that the Department establish and periodically adjust interest rates on existing Contracts of Purchase sufficient to, among other things, maintain the solvency of the 1943 Fund. The Department plans in 1998 to seek legislative changes which (i) will eliminate the uniform interest rate requirements for Contracts of Purchase, and (ii) will allow the Department to establish fixed interest rates for such Contracts of Purchase. The earliest effective date of such legislation is likely to be January 1, 1999. There is no assurance that such legislation will be enacted, but if enacted, the requirements that the interest rates on all Contracts of Purchase must be uniform and periodically adjusted will no longer apply.

See "PLAN OF FINANCE AND PROGRAMMATIC CHANGES" for a discussion of the Department's plan to reduce the interest rates on existing Contracts of Purchase. For additional information regarding the existing interest rates of and setting interest rates on Contracts of Purchase, see "THE PROGRAM—Contracts of Purchase" and Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Contracts of Purchase."

Bond Reserve Account

The Resolution requires the establishment and, from available Revenues, maintenance of a Bond Reserve Account in an amount at least equal to the Bond Reserve Requirement. The Resolution establishes the Bond Reserve Account Requirement as of any date of calculation to be an amount equal to the aggregate of the amounts established by the Ninth Supplemental Resolution and each Series Resolution authorizing Additional Revenue Bonds, at least equal in the aggregate to 3% of the aggregate Outstanding principal amount of the Revenue Bonds with interest rates fixed to maturity (the "Bond Reserve Requirement"). For purposes of calculating the Bond Reserve Requirement, the Ninth Supplemental Resolution establishes with respect to the Offered Revenue Bonds an amount equal to 7% of the Outstanding principal amount of the Offered Revenue Bonds with interest rates fixed to maturity. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and interest on the Revenue Bonds or making Mandatory Sinking Account Payments (but only in the event that no

other moneys other than certain moneys in the Revenue Bond Series Bond Proceeds Subaccounts or Revenue Bond Series Proceeds Recycling Subaccounts are available therefor). Amounts on deposit in the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement will be transferred at the request of the Department to the Loan Loss Account, the Revenue Account or the Proceeds Account. The Resolution creates a first lien in favor of the holders of the Revenue Bonds on amounts in the Bond Reserve Account.

Although the Department expects to use cash to fund the Bond Reserve Account Requirement with respect to the Offered Revenue Bonds, the Ninth Supplemental Resolution provides that Cash Equivalents may replace such cash in the future. The Resolution permits Series Resolutions authorizing Additional Revenue Bonds to provide that Cash Equivalents be used to fund the Bond Reserve Requirement with respect to the Series of Bonds so authorized.

Loan Loss Account

The Resolution requires that the amount on deposit in the Loan Loss Account must be at least equal to the Loan Loss Requirement before the Offered Revenue Bonds or any Additional Revenue Bonds may be issued. The Resolution establishes the Loan Loss Requirement, as of any date of calculation, as an amount equal to the amount established in the then-current Cash Flow Statement, as described below under "Cash Flow Statements and Program Operating Procedures." The Cash Flow Statement which will be in effect upon the issuance of the Offered Revenue Bonds will not establish a Loan Loss Requirement. The Resolution provides that, pursuant to the Program Operating Procedures, moneys held for the credit of the Loan Loss Account as of any date at the request of the Department will be transferred to the Revenue Account, the Bond Reserve Account, the Proceeds Account or any Revenue Subaccount established with respect to the Veterans G.O. Bonds. Amounts in the Loan Loss Account will be used to pay the principal of and interest on the Revenue Bonds or to make Mandatory Sinking Account Payments.

The Resolution permits Series Resolutions authorizing future series of Revenue Bonds to provide that Cash Equivalents be used to fund the Loan Loss Requirement with respect to the Series of Bonds so authorized.

Cash Flow Statements and Program Operating Procedures

The Resolution requires that the Department file a current Cash Flow Statement with the Trustee (i) upon adoption of a resolution authorizing Additional Revenue Bonds or amending the Resolution, (ii) upon the issuance of any series of Veterans G.O. Bonds, (iii) when required pursuant to any Series Resolution or Supplemental Resolution, (iv) upon any change in the Program Operating Procedures described below, and (v) in connection with complying with the requirements described below under "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS—Maintenance of Fund Parity." The Department may also file a new Cash Flow Statement at any time. Any Cash Flow Statement will be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

A Cash Flow Statement consists of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Revenue Bonds and Expenses. under each of the scenarios included in the cash flow projections attached thereto. Under the Resolution, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect of the Contracts of Purchase, (ii) interest earnings received on the investment of

amounts to the extent deposited in the Revenue Account under the Resolution, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account or the Loan Loss Account, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any Series Resolution.

A Cash Flow Statement will (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account and the Loan Loss Account as of the stated starting date of the projection, (ii) reflect all the significant transactions that have occurred in the period commencing with such starting date and ending with a date no more than ninety (90) days prior to the date of such projections, (iii) be consistent with the Resolution and (iv) assume compliance with the then current Program Operating Procedures. For each scenario included therein, the Cash Flow Statement will set forth the assumptions on which it is based including, without limitation, the following:

- (i) the timing and terms of issuance or remarketing of Revenue Bonds and Veterans G.O. Bonds;
- (ii) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;
- (iii) the timing and amounts of the receipt of payments of scheduled principal of and interest on Contracts of Purchase;
- (iv) the timing and amounts of prepayments on Contracts of Purchase;
- (v) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;
- (vi) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will be subject to an investment agreement;
- (vii) the performance by the Department's counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds;
- (viii) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and
- (ix) the Loan Loss Requirement.

The Department will not be in default under the Resolution if any Cash Flow Statement shows that projected Revenues will be insufficient to provide for timely payments of interest on and principal of the Revenue Bonds and Expenses, but will take all reasonable actions to eliminate such deficiency.

The Program Operating Procedures are operating policies of the Department governing discretionary activities under the Resolution. The Resolution requires the Department to administer the Program and perform its obligations under the Resolution in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures may be amended if (1) a Cash Flow Statement is delivered to the Trustee, and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on the Revenue Bonds from the gross income of the holders thereof for federal income tax purposes.

Cash Flow Statement to be Delivered in Connection with the Offered Revenue Bonds

As a condition to the issuance of the Offered Revenue Bonds expected to be delivered on December 29, 1997, the Department will provide the Trustee with its Cash Flow Statement in the form required by the Resolution. The Cash Flow Statement will consist of the conclusion by an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Revenue Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto (the "Issuance Cash Flow Projections"). The Issuance Cash Flow Projections will be prepared by cfX Incorporated ("cfX"), pursuant to its engagement as Quantitative Consultant to the Department. The Issuance Cash Flow Projections and the conclusions of cfX contained in its accompanying cash flow letter will be based solely on information provided to cfX by the Department and the Trustee and certain assumptions provided to cfX by the Department and upon scenarios generally specified by the Rating Agencies to be tested; cfX makes no representation with respect to the accuracy of such information or as to the reasonableness of such assumptions and scenarios. The Department will be required to provide the Trustee with an additional Cash Flow Statement as of the delivery of the 1998 Series A Bonds, expected to be May 5, 1998. cfX expects to provide replacement cash flow projections prior to that time, but can provide no assurance that intervening events will not prevent the Department from reaching the required conclusion in such Cash Flow Statement.

The Issuance Cash Flow Projections will be based on the financial condition of the 1943 Fund as of June 30, 1997 (as presented in the audited financial statements of the 1943 Fund) and will reflect significant financial transactions within the 1943 Fund through October 7, 1997, as explained to cfX by the Department. The Issuance Cash Flow Projections will reflect (i) the assumed delivery of the Offered Revenue Bonds, the 1997 Veterans G.O. Bonds, and 1998 Veterans G.O. Bonds as part of the overall financing plan (but no additional future issuance of either Revenue Bonds or Veterans G.O. Bonds), and (ii) the initial application of proceeds of such bonds in accordance with the Department's expected terms of the applicable resolutions. The Issuance Cash Flow Projections will assume that the 1997 Series C Bonds and the 1997 Veterans G.O. Bonds designated Series BJ are redeemed (and not remarketed) on their respective initial mandatory tender dates.

The Issuance Cash Flow Projections will include each of the scenarios generally specified by the Rating Agencies and included in the final presentations to the Rating Agencies in connection with the Department's application for an appropriate rating on the Offered Revenue Bonds. Such scenarios reflect a combination of assumptions required by the Rating Agencies to be used with respect to future market conditions and behavior of eligible and participating veterans under such market conditions. cfX makes no representation with respect to the sufficiency of Revenues to provide for timely payments of interest and principal on the Revenue Bonds and Expenses under any scenario not presented in the Issuance Cash Flow Projections. Among other assumptions, the Issuance Cash Flow Projections will include scenarios under which:

- (i) The 1998 Series A Bonds are not issued.
- (ii) The 1998 Veterans G.O. Bonds are not issued.
- (iii) No future prepayments are received with respect to Contracts of Purchase, or, alternatively, that prepayments are received at a number of specified annualized constant prepayment rates.
- (iv) As of specified dates no additional Contracts of Purchase are funded and unexpended amounts are applied to the redemption of Revenue Bonds and Veterans G.O. Bonds.
- (v) A specified level of unreimbursed losses are incurred with respect to defaulted Contracts of Purchase.

Each scenario in the Issuance Cash Flow Projections reflects future transactions to be executed by the Department and the Trustee (among others) with respect to: (i) the application for Program purposes of amounts in the Proceeds Account established under the Resolution, (ii) the collection and deposit of Revenues, (iii) the investment of amounts on deposit in various Accounts in both specified and unspecified investments, (iv) the transfer of funds between Accounts, (v) the payment of Expenses, and (vi) the redemption of Revenue Bonds and Veterans G.O. Bonds. All of the scenarios included in Issuance Cash Flow Projections assume that the Department and the Trustee execute such transactions on a timely basis in conformance with the requirements of the Resolution, the resolutions authorizing the issuance of the Offered Revenue Bonds and future Series of Revenue Bonds, the Program Operating Procedures, and the provider of third party investment contracts. *cfX can provide no assurance that such actions will be timely taken.*

Each scenario in the Issuance Cash Flow Projections reflects future performance of third parties under investment and insurance contracts, and assumes no default in performance. Each scenario also assumes that, with the exception of reserves and liabilities reflected on the 1943 Fund audited financial statements as of June 30, 1997, future operations of the life and disability insurance and property insurance programs offered by the Department will neither contribute to, nor require support from, the 1943 Fund.

Maintenance of Fund Parity

The Resolution requires that the Department cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals 50% (or such other percentage set forth in the Program Operating Procedures) (the "Applicable Fund Parity Percentage") (provided that any percentage which is less than 50% shall be the subject of a Rating Confirmation) of the then Outstanding principal amount of Revenue Bonds, all Revenues in excess of Accrued Debt Service on the Revenue Bonds and Veterans G.O. Bonds shall thereafter be applied to redeem Revenue Bonds of the Series and in the manner reflected in a current Cash Flow Statement, until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such Applicable Fund Parity Percentage; provided, further, however, that no such Cash Flow Statement and no such redemption shall be required if the Department shall have provided a Rating Confirmation to the Trustee. Under the Resolution, "Fund Parity" means, on any determination date, (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established under the Resolution, and (ii) the principal amount of all Revenue Bonds Outstanding and all Veterans G.O. Bonds outstanding (plus accrued interest) reduced by (b) allowances and reserves for loss coverage on Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures. The Resolution provides that "Accrued Debt Service" means, as of any date of determination and, as the context of the Resolution requires, with respect to all Revenue Bonds and Veterans G.O. Bonds, the sum of:

(a) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) below) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(b) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(c) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans G.O. Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

Under the Resolution, "Monthly Debt Service Requirement" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

Additional Revenue Bonds

The Resolution permits the issuance of series of Additional Revenue Bonds to carry out the provisions of the Act and other statutes enacted in support of the Program or to refund all or part of the Revenue Bonds then Outstanding. Any series of Additional Revenue Bonds issued under the Resolution will be on a parity with the then Outstanding Revenue Bonds, and will be entitled to the equal benefit, protection and security of the provisions, covenants and agreements of the Resolution. Additional Revenue Bonds may have interest payment dates which differ from those of the Offered Revenue Bonds. Upon the issuance of any such series of Additional Revenue Bonds, the Resolution requires the deposit into the Bond Reserve Account and the Loan Loss Account such amounts as are necessary to increase the amounts therein to, respectively, the Bond Reserve Requirement or the Loan Loss Requirement. Such deposit may be made from the 1943 Fund, the proceeds of sale of the series of Additional Revenue Bonds or any other lawful source, or through the use of Cash Equivalents as provided in the Series Resolution authorizing the issuance of the series of Additional Revenue Bonds. Issuance of Additional Revenue Bonds is conditioned upon delivery of a Cash Flow Statement and Rating Confirmation and upon certification that no Event of Default under the Resolution shall have occurred and be continuing.

Additional Veterans G.O. Bonds (including the 1998 Veterans G.O. Bonds) authorized by the voters of the State may be issued by the State from time to time to provide funds for the Program or to refund outstanding Veterans G.O. Bonds, subject to the delivery of a Cash Flow Statement. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS—The 1943 Fund" for a discussion of authorized but unissued bonds.

THE 1998 SERIES A MUNICIPAL BOND INSURANCE POLICY

General

The 1998 Series A Bonds are expected to be the subject of a 1998 Series A Municipal Bond Insurance Policy described under this heading to be issued by the Insurer. The 1998 Series A Municipal Bond Insurance Policy is not a source of payment for any Revenue Bonds other than the 1998 Series A Bonds.

The summary of the terms of the 1998 Series A Municipal Bond Insurance Policy set forth below under the subcaption "The Insurer and the 1998 Series A Municipal Bond Insurance Policy" does not purport to be complete and is qualified in its entirety by reference to the 1998 Series A Municipal Bond Insurance Policy, the form of which appears in Exhibit F hereto. All capitalized terms used under such subcaption and not otherwise defined in this Official Statement are used as defined in the 1998 Series A Municipal Bond Insurance Policy.

The information relating to the Insurer contained below under the subcaption "The Insurer and the 1998 Series A Municipal Bond Insurance Policy" has been furnished by the Insurer and neither the Department, the Trustee, nor the Underwriters have undertaken any independent

investigation of the Insurer, its operations, or its municipal bond insurance. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof. Neither the Department, the Trustee, nor the Underwriters make any representation as to the ability of the Insurer to make payments under the 1998 Series A Municipal Bond Insurance Policy. See Exhibit F—"Form of 1998 Series A Municipal Bond Insurance Policy." A Statement of Insurance relating to the 1998 Series A Municipal Bond Insurance Policy will be printed on the 1998 Series A Bonds.

The Insurer and the 1998 Series A Municipal Bond Insurance Policy

The following information has been furnished by the Insurer for use in this Official Statement. Reference is made to Exhibit F for a specimen of the 1998 Series A Municipal Bond Insurance Policy.

The Insurer has made a commitment to issue the 1998 Series A Municipal Bond Insurance Policy effective as of the date of issuance of the 1998 Series A Bonds. Under the terms of the 1998 Series A Municipal Bond Insurance Policy, the Insurer will pay to the United States Trust Company of New York, in New York, New York or any successor thereto (the "Insurance Trustee") that portion of the principal of and interest on the 1998 Series A Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer (as such terms are defined in the 1998 Series A Municipal Bond Insurance Policy). The Insurer will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which the Insurer shall have received notice of Nonpayment from the Trustee. The insurance will extend for the term of the 1998 Series A Bonds and, once issued, cannot be canceled by the Insurer.

The 1998 Series A Municipal Bond Insurance Policy will insure payment of 1998 Series A Bonds only on stated maturity dates and on dates on which Mandatory Sinking Account Payments are required to be paid, in the case of principal, and on stated dates for payment, in the case of interest. If the 1998 Series A Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all Outstanding 1998 Series A Bonds, the Insurer will remain obligated to pay principal of and interest on Outstanding 1998 Series A Bonds on the originally scheduled interest and principal payment dates and dates on which Mandatory Sinking Account Payments are required to be paid. In the event of any acceleration of the principal of the 1998 Series A Bonds, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration.

In the event the Trustee has notice that any payment of principal of or interest on a 1998 Series A Bond which has become Due for Payment and which is made to a Bondowner by or on behalf of the Department has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from the Insurer to the extent of such recovery if sufficient funds are not otherwise available.

The 1998 Series A Municipal Bond Insurance Policy does **not** insure any risk other than Nonpayment, as defined in the 1998 Series A Municipal Bond Insurance Policy. Specifically, the 1998 Series A Municipal Bond Insurance Policy does **not** cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory redemption from Mandatory Sinking Account Payments) or as a result of any other advancement of maturity, (ii) payment of any redemption, prepayment or acceleration premium, and (iii) nonpayment of principal or interest caused by the insolvency or negligence of the Trustee.

If it becomes necessary to call upon the 1998 Series A Municipal Bond Insurance Policy, payment of principal requires surrender of 1998 Series A Bonds to the Insurance Trustee together

with an appropriate instrument of assignment so as to permit ownership of such 1998 Series A Bonds to be registered in the name of the Insurer to the extent of the payment under the 1998 Series A Municipal Bond Insurance Policy. Payment of interest pursuant to the 1998 Series A Municipal Bond Insurance Policy requires proof of Bondowner entitlement to interest payments and an appropriate assignment of the Bondowner's right to payment to the Insurer.

Upon payment of the insurance benefits, the Insurer will become the owner of the 1998 Series A Bond, appurtenant coupon, if any, or right to payment of principal or interest on such 1998 Series A Bond and will be fully subrogated to the surrendering Bondowner's rights to payment.

In the event that the Insurer were to become insolvent, any claims arising under the 1998 Series A Municipal Bond Insurance Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

The Insurer is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam, and the Commonwealth of Puerto Rico, with admitted assets of approximately \$2,813,000,000 (unaudited) and statutory capital of approximately \$1,605,000,000 (unaudited) as of September 30, 1997. Statutory capital consists of the Insurer's policyholders' surplus and statutory contingency reserve. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), Moody's Investors Service ("Moody's") and Fitch IBCA, Inc. ("Fitch") have each assigned a triple-A claims-paying ability rating to the Insurer.

The Insurer has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by the Insurer will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by the Insurer under policy provisions substantially identical to those contained in its 1998 Series A Municipal Bond Insurance Policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the issuer of the 1998 Series A Bonds.

The Insurer makes no representation regarding the 1998 Series A Bonds or the advisability of investing in the 1998 Series A Bonds and makes no representation regarding, nor has it participated in the preparation of, this Official Statement other than the information supplied by the Insurer in this section and in Exhibit F.

The parent company of the Insurer, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional offices at 7 World Trade Center, New York, New York 10048 and Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. In addition, the aforementioned material may also be inspected at the offices of the New York Stock Exchange, Inc. (the "NYSE") at 20 Broad Street, New York, New York 10005. The Company's Common Stock is listed on the NYSE.

Copies of the Insurer's financial statements prepared in accordance with statutory accounting standards are available from the Insurer. The address of the Insurer's administrative offices and its telephone number are One State Street Plaza, 17th Floor, New York, New York 10004 and (212) 668-0340.

The following documents filed by the Company with the Commission (File No. 1-10777) are incorporated by reference in this Official Statement:

(1) The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 and filed on March 31, 1997;

(2) The Company's Current Report on Form 8-K dated March 12, 1997 and filed on March 12, 1997;

(3) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 1997 and filed on May 15, 1997;

(4) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 1997 and filed on August 14, 1997; and

(5) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended September 30, 1997 and filed on November 14, 1997.

All documents filed by the Company pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above.

[the balance of this page is intentionally left blank]

SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION

Selected Financial Data of the 1943 Fund

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1997 and 1996 has been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in Exhibit A to this Official Statement. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1995, 1994 and 1993 has also been derived from the audited financial statements of the 1943 Fund which are not included herein. This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in Exhibit A and the Department's Discussion of Financial Data contained herein.

SELECTED FINANCIAL DATA OF THE 1943 FUND (Thousands of Dollars)

	June 30, 1997	June 30, 1996	June 30, 1995	June 30, 1994	June 30, 1993
	Income Statement Items				
NET INCOME (EXPENSE) FROM LENDING AND FINANCING ACTIVITIES					
INTEREST INCOME					
Interest on Contracts	\$ 175,186	\$ 182,636	\$ 181,595	\$ 185,040	\$ 204,813
Interest on Investments	67,373	79,510	76,846	83,153	86,734
Transfers of Interest from Veterans Debtenture Revenue Fund	10,843	11,144	11,164	11,031	11,131
Total	253,402	273,290	269,605	279,224	302,678
BOND INTEREST EXPENSE	(230,871)	(245,971)	(252,792)	(274,271)	(309,629)
<i>Net Interest Income (Expense)</i>	<u>22,531</u>	<u>27,319</u>	<u>16,813</u>	<u>4,953</u>	<u>(6,951)</u>
CONTRACTS OF PURCHASE					
Net Loss on Sale of REO's	(8,309)	(5,510)	(2,200)	(945)	(160)
Provision to Increase the Allowance for Contract Losses	(22,677)	(5,515)	(10,463)	(10,837)	(1,800)
Total	(30,986)	(11,025)	(12,663)	(11,782)	(1,960)
<i>Net Lending And Financing Activities Income (Expense)</i>	<u>(8,455)</u>	<u>16,294</u>	<u>4,150</u>	<u>(6,829)</u>	<u>(8,911)</u>
NET EXPENSE FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenue	2,290	1,769	2,768	1,617	2,062
Operating Expenses	(20,218)	(18,810)	(17,675)	(18,973)	(19,018)
<i>Net Administrative Activities Expense</i>	<u>(17,928)</u>	<u>(17,041)</u>	<u>(14,907)</u>	<u>(17,356)</u>	<u>(16,956)</u>
NET INCOME (EXPENSE) FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	3,570	(5,424)	(13,781)	(1,152)	(16,016)
Fire and Hazard Coverage	326	(538)	(4,202)	3,809	(3,648)
<i>Net Insurance Activities Income (Expense)</i>	<u>3,896</u>	<u>(5,692)</u>	<u>(17,983)</u>	<u>(2,657)</u>	<u>(19,664)</u>
TOTAL DEFICIENCY OF REVENUES AND TRANSFERS OVER EXPENSES	<u>(22,487)</u>	<u>(6,709)</u>	<u>(28,740)</u>	<u>(21,528)</u>	<u>(45,531)</u>
RETAINED EARNINGS	<u>\$ 258,153</u>	<u>\$ 280,640</u>	<u>\$ 287,349</u>	<u>\$ 316,089</u>	<u>\$ 337,617</u>

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Thousands of Dollars)*

	June 30, 1997	June 30, 1996	June 30, 1995	June 30, 1994	June 30, 1993
	Balance Sheet Items				
ASSETS AND LIABILITIES—LENDING AND FINANCING ACTIVITIES					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF	\$ 317,178	\$ 295,140	\$ 306,269	\$ 1,058,832	\$ 1,193,472
Guaranteed Investment Contracts	365,542	475,744	591,449	326,638	360,493
Treasury Securities	332,760	355,900	378,628	54,150	55,472
Total	1,015,480	1,126,784	1,276,346	1,439,620	1,609,437
DUE FROM VETERANS DEBENTURE REVENUE FUND	86,279	137,141	137,166	137,108	137,221
OTHER CURRENT ASSETS	22,596	26,191	25,787	24,819	39,667
NET OTHER NON-CURRENT ASSETS	15,123	15,824	16,600	13,255	14,888
CONTRACTS OF PURCHASE					
Performing Contracts	2,154,142	2,231,994	2,356,818	2,185,107	2,499,994
REO Contracts at Carrying Value	75,038	74,268	53,257	40,619	32,300
Total	2,229,180	2,306,262	2,410,075	2,225,726	2,532,294
Allowance for Uncollectable Contracts	(26,412)	(15,801)	(15,066)	(16,937)	(6,100)
Markdown of REO to Fair Value	(24,003)	(17,113)	(12,334)	0	0
Total	(50,415)	(32,914)	(27,400)	(16,937)	(6,100)
BONDS PAYABLE					
General Obligation Bonds	(2,632,045)	(2,812,810)	(3,002,695)	(2,802,260)	(3,015,850)
Revenue Bonds	(327,580)	(374,975)	(434,545)	(600,890)	(853,495)
Total	(2,959,625)	(3,187,785)	(3,437,240)	(3,403,150)	(3,869,345)
ACCRUED INTEREST AND OTHER CURRENT LIABILITIES	(80,502)	(86,716)	(90,868)	(96,821)	(104,371)
<i>Net Lending and Financing Assets</i>	<u>278,116</u>	<u>304,787</u>	<u>310,466</u>	<u>323,620</u>	<u>353,691</u>
ASSETS AND LIABILITIES—INSURANCE ACTIVITIES					
LIFE AND DISABILITY COVERAGE					
Deposits with Insurance Administrators	47,270	56,843	61,625	63,892	63,932
Insurance Reserves and Claims Payable	(65,828)	(78,246)	(79,729)	(68,214)	(74,140)
Total	(18,558)	(21,403)	(18,104)	(4,322)	(10,208)
FIRE AND HAZARD COVERAGE					
Net Deposit with Insurance Administrators and Insurance Reserves and Claims Payable	(1,405)	(2,744)	(5,013)	(3,209)	(5,866)
<i>Net Insurance Liabilities</i>	<u>(19,963)</u>	<u>(24,147)</u>	<u>(23,117)</u>	<u>(7,531)</u>	<u>(16,074)</u>
RETAINED EARNINGS	\$ 258,153	\$ 280,640	\$ 287,349	\$ 316,089	\$ 337,617
SUMMARY INFORMATION					
Total Assets	\$ 3,361,050	\$ 3,631,714	\$ 3,895,818	\$ 3,887,151	\$ 4,390,288
Total Liabilities	\$ 3,102,897	\$ 3,351,074	\$ 3,608,469	\$ 3,571,062	\$ 4,052,671
Total Number of Contracts of Purchase	39,343	42,650	47,075	48,341	57,992

*Except for Total Number of Contracts of Purchase

Department's Discussion of Financial Data

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of \$258,153,000 as of June 30, 1997. This balance has decreased approximately 32.6 percent since year-end FY 1992 when it peaked at \$383,148,000. While retained earnings have decreased in recent years, the overall asset-to-liability ratio for the 1943 Fund has remained nearly constant at approximately 108.0 during the same period. The total deficiency of revenues for the Program for FY 1997 was \$22,487,000 compared to \$6,709,000 in FY 1996. The aggregate deficiency of revenues for the Program during the five-year period reflected in the tables above was \$124,995,000.

As further described below, the Program has experienced significant losses during the last five years for three principal reasons: (i) a low interest rate environment that produced higher prepayment levels and decreased investment earnings on bond proceeds and other invested funds in the 1943 Fund during FY 1993 and FY 1994; (ii) financial losses associated with the Department's self-insured life and disability and property insurance programs during FY 1993 through FY 1996; and (iii) losses on sale of repossessed properties and allowances for losses associated with the Department's portfolio of Contracts of Purchase during FY 1994 through FY 1997. However, as discussed below, the Department has recently undertaken major initiatives to address each of these areas and expects such actions to have a positive impact on future years' financial performance.

The Program's FY 1997 net interest income (total interest income less bond interest expense) of \$22,531,000 was \$4,788,000 less than FY 1996. This decrease was attributable to net adjustments of \$4,968,000 to FY 1996 net interest income for previously unrecorded investment interest and over-accrual of bond interest expense. Accordingly, FY 1997 net interest income reflected an increase of \$180,000 compared to the FY 1996 amount before adjustment, despite a continued decline in the principal balance of outstanding Contracts of Purchase and invested funds. As a result, net interest margin (net interest income divided by interest bearing assets) increased from 0.63% in FY 1996 (before adjustment) to 0.68% in FY 1997. These results compare favorably to those of the earlier years represented in the table above and reflect the Department's continuing efforts over the last several years to reduce debt service cost and increase interest income. These efforts have included, where possible, redemption of outstanding higher interest rate bonds prior to maturity and the transfer of certain invested funds from lower yielding variable rate instruments to higher yielding fixed rate investments. Notwithstanding these recent actions, the Department's future net interest income will continue to be adversely affected by \$909,650,000 (as of September 30, 1997) of outstanding non-callable Veterans G.O. Bonds with an average interest cost of approximately 9.00% which cannot be fully retired before the year 2010 (See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Veterans G.O. Bonds and Prior Revenue Bonds").

Like all loan portfolios, the Program experienced fluctuating levels of prepayments and new originations of Contracts of Purchase primarily influenced by the rates of interest of conventional mortgage financing relative to the Program's interest rates (either 8.00% or 7.75% during the period reflected in the table above). The net effect of these factors resulted in the outstanding principal balance of Contracts of Purchase declining 12.0% since June 30, 1993. (See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" for detailed information regarding the history of repayments, prepayments and originations of Contracts of Purchase.) During the same period, cash and invested funds dropped 36.9% due primarily to the use of such assets to pay bond maturities or redeem bonds and fund new Contracts of Purchase. In aggregate, total Program assets have declined 23.4% since June 30, 1993. The debt structure of the Program, however, accommodated this downward trend in assets through a series of bond redemptions which resulted in a nearly equivalent reduction in the bonds outstanding.

Due to the decline in real estate values in certain California housing sub-markets in the early 1990's and the concentration of the Department's Contract of Purchase portfolio in certain areas of the State which were economically depressed due to military base closures and defense industry employment reductions, the number of repossessed properties (REOs) and their loss on sale have both increased significantly since FY 1994. The principal balance of Contracts of Purchase classified as REO increased from \$14,395,000 at June 30, 1992 to \$75,038,000 at June 30, 1997. Aggregate net losses on sales of REOs increased sharply beginning in FY 1995 and totalled \$17,124,000 from FY 1993 through FY 1997, representing 0.77% of the total principal amount of Contracts of Purchase outstanding at June 30, 1997. During FY 1996 and FY 1997, the Department moved aggressively to repossess properties of cancelled Contracts of Purchase and to dispose of its REOs. Losses resulting from such increased REO disposition efforts were compounded by the negative real estate market factors cited above, causing the Department to reassess the adequacy of its loan loss allowance. Accordingly, the Department's allowance for loan losses was increased by two-thirds in FY 1997 compared to FY 1996. This loan loss allowance increase, together with reductions in the estimated disposition value of its current REO portfolio, has resulted in a cumulative net charge to operations of \$50,415,000 to provide for potential losses in the portfolio. These actions, together with the Department's plan to obtain primary mortgage insurance with respect to certain existing Contracts of Purchase with high loan-to-value ratios (See "THE PROGRAM—Loan Insurance"), are expected to provide for future potential REO losses.

Program administrative operating expenses in FY 1997 increased by \$1,408,000, or 7.5%, due in large part to consulting expenses and personnel costs relating to identifying and developing strategies to: improve overall Program operations; procure a state-of-the-art integrated mortgage and finance computer system; and complete conversion of the life and disability insurance program to an outside commercial insurer. After taking into effect a \$521,000 increase in operating revenue, net administrative operating expenses increased 5.2% over FY 1996 results.

Effective June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured plan underwritten by an outside commercial insurer except for that portion of the program covering existing claims of disabled contract holders for whom the Department continues to provide coverage. Loss reserves for these obligations have been actuarially determined. More than two-thirds of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability. The net effect of these changes resulted in the plan operating on a break-even basis in FY 1997 compared to aggregate losses of \$36,373,000 over the four prior fiscal years.

Effective November 1, 1996, a number of changes were made to the Department's fire and hazard insurance coverage, including increasing the deductible, eliminating outdated loss coverages and limiting the claims period. These changes have resulted in stabilized financial operations for the Department's fire and hazard coverage over the last two fiscal years.

Further financial information relating to the 1943 Fund can be located in Exhibit A to this Official Statement.

THE OFFERED REVENUE BONDS

General

The 1997 Series A Bonds, 1997 Series B Bonds, and 1998 Series A Bonds will be dated, will bear interest at the rates and mature in the amounts and on the dates set forth on the inside front cover page of this Official Statement. Interest will be payable on the 1997 Series A Bonds, 1997 Series B Bonds, and 1998 Series A Bonds semiannually on June 1 and December 1 of each year, commencing June 1, 1998 for the 1997 Series A Bonds and 1997 Series B Bonds, and on December 1, 1998 for the 1998 Series A Bonds. The 1997 Series C Bonds are subject to mandatory tender (with no right to retain), will be dated their date of delivery, and will bear interest at the rate, payable on June 1 and December 1 of each year, commencing June 1, 1998, and on their Mandatory Tender Date, as set forth on the inside front cover page of this Official Statement. **This Official Statement is not intended to provide any information with respect to any 1997 Series C Bond after its applicable Mandatory Tender Date.** Interest on the Offered Revenue Bonds is calculated on the basis of a 360-day year consisting of twelve 30-day months.

Offered Revenue Bonds will be delivered in fully registered form only and when delivered will be registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Offered Revenue Bonds. The Offered Revenue Bonds are issuable in book-entry form only in denominations of \$5,000 and any integral multiple thereof. See "BOOK-ENTRY ONLY SYSTEM."

Redemption

Redemption from Mandatory Sinking Account Payments

The 1997 Series A Bonds maturing on December 1, 2028 (the "1997A 2028 Term Bonds"), 1997 Series B Bonds maturing December 1, 2018 (the "1997B 2018 Term Bonds"), the 1998 Series A Bonds maturing December 1, 2018 (the "PAC Bonds"), and the 1998 Series A Bonds maturing December 1, 2019 (the "Super Sinker Bonds") are subject to mandatory redemption prior to their respective stated maturities, in part, by lot, at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the date fixed for redemption, without premium, from Mandatory Sinking Account Payments, on the respective dates and in the respective amounts set forth in Exhibit B—"MANDATORY SINKING ACCOUNT PAYMENTS."

Pursuant to the Resolution, if less than all of the Term Bonds of a maturity of the Offered Revenue Bonds are purchased or called for redemption (other than in satisfaction of Mandatory Sinking Account Payments), the Trustee will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity dates, as shown above) as directed by the Department or, if no direction is given, then against all applicable remaining Mandatory Sinking Account Payments in the proportion that the then-remaining balance of each such Mandatory Sinking Account Payment (including the principal amount due on the respective maturity date, as shown above) bears to the total of all applicable Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity date, as shown above).

The 1997 Series C Bonds are not subject to redemption from Mandatory Sinking Account Payments prior to their applicable Mandatory Tender Dates.

Optional Redemption

The 1997 Series A Bonds, 1997 Series B Bonds, and 1998 Series A Bonds are subject to redemption at any time on or after December 1, 2008 at the option of the Department, and from any source of available funds, as a whole or in part by such maturity or maturities of a series, and such amounts within each such maturity, as may be selected by the Department in its sole discretion (and by lot within a maturity of a series), at redemption prices equal to the following amounts (expressed as percentages of the principal amount of the 1997 Series A Bonds, 1997 Series B Bonds, and 1998 Series A Bonds or portion thereof to be redeemed) plus accrued interest to the date fixed for redemption, as follows:

Redemption Period (both dates inclusive)	Redemption Price
December 1, 2008 to and including November 30, 2009	101%
December 1, 2009 and thereafter	100

The 1997 Series C Bonds are subject to redemption on their Mandatory Tender Date or any date which could be designated a Mandatory Tender Date, at the option of the Department, and from any source of available funds, as a whole or in part at a redemption price equal to the principal amount thereof, together with accrued interest to the redemption date.

Special Redemption from Unexpended Proceeds, Certain Restricted Recoveries and Excess Revenues

The 1997 Series A Bonds, 1997 Series B Bonds and 1998 Series A Bonds are subject to redemption at the option of the Department in whole or in part at any time, at a redemption price equal to 100% of the principal amount thereof plus interest accrued thereon to the date fixed for redemption in an amount equal to (i) moneys deposited in the Revenue Bond Series Proceeds Subaccount with respect to the 1997 Series A Bonds, 1997 Series B Bonds and 1998 Series A Bonds on the date of issuance of the Offered Revenue Bonds that have not been applied to redeem Prior Revenue Bonds or to finance Contracts of Purchase; (ii) 1997/1998 Restricted Recoveries which are not required to redeem the PAC Bonds or Super Sinker Bonds as described under "Mandatory Redemption from Allocated Prior Contracts Restricted Recoveries" and (iii) Excess Revenues. "1997/1998 Restricted Recoveries" means all Allocated Prior Contracts Restricted Recoveries (as defined below) and all prepayments and scheduled repayments of principal attributable to Contracts of Purchase financed by the 1997 Series C Bonds. The 1997 Series A Bonds, 1997 Series B Bonds and 1998 Series A Bonds to be so redeemed shall be such maturities, and such amounts within a maturity, as shall be selected by the Department, except that the PAC Bonds are not subject to redemption from 1997/1998 Restricted Recoveries except as described under "Mandatory Redemption from Allocated Prior Contracts Restricted Recoveries" until no other 1997 Series A Bonds, 1997 Series B Bonds or 1998 Series A Bonds are Outstanding.

Excess Revenues (defined in "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION—Definitions (Section 103)") can include prepayments and repayments on Contracts of Purchase funded by both Revenue Bonds, Prior Revenue Bonds, and Veterans G.O. Bonds, and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. See "THE OFFERED REVENUE BONDS—Redemption—Information Regarding Prepayments" for additional information regarding prepayments of Contracts of Purchase.

Additional moneys may become available to finance Contracts of Purchase through the future issuances of Revenue Bonds and Veterans G.O. Bonds. The Department, subject to the applicable authorizing resolutions, has full discretion to use moneys available from prior, current or future bond issues to finance Contracts of Purchase in any order of priority it chooses. See Exhibit

D—"CERTAIN DEPARTMENT INFORMATION AND OPERATING DATA—Contracts of Purchase—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Mandatory Redemption from Allocated Prior Contracts Restricted Recoveries

General. The PAC Bonds and Super Sinker Bonds are subject to redemption, in whole or in part, as described under this heading, from Allocated Prior Contracts Restricted Recoveries on or after June 1, 1998, on any one or more dates during each semiannual period. "Allocated Prior Contracts Restricted Recoveries" are all prepayments and repayments of Allocated Prior Revenue Bonds Contracts of Purchase (as defined below) that are actually received. Such mandatory redemptions shall be upon notice as provided in the Resolution, and the redemption price shall equal 100% of the principal amount thereof to be redeemed plus accrued interest thereon to the date fixed for redemption.

[the balance of this page is intentionally left blank]

Mandatory Redemption of PAC Bonds. Such redemption of PAC Bonds may occur at any time, on or after June 1, 1998, at the option of the Department, and must occur on each June 1 and December 1, but only if, at the time of calculation, (1) there are Allocated Prior Contracts Restricted Recoveries and (2) the aggregate outstanding principal amount of PAC Bonds exceeds the amount set forth below (each, a "PAC Outstanding Amount") for such semiannual period. (The Department is not required to redeem the PAC Bonds, however, unless the Allocated Prior Contracts Restricted Recoveries at the time equals at least \$250,000.) The PAC Outstanding Amounts have been calculated based upon assumptions that include, among other assumptions, that the Allocated Prior Revenue Bonds Contracts of Purchase (as defined below) (i) bear interest at a per annum rate substantially lower than the current interest rate (see "PLAN OF FINANCE AND PROGRAMMATIC CHANGES—Programmatic Changes"), and (ii) prepay at an annualized rate of 4.50% per year. The Department makes no representation that actual experience will conform to these assumptions. If actual experience differs from these assumptions, the principal amount of PAC Bonds actually redeemed in each semiannual period pursuant to the provisions described under this heading may differ from that embodied in the PAC Outstanding Amounts.

<u>Semiannual Period Ending</u>	<u>PAC Outstanding Amounts</u>
December 1, 1998	\$65,910,000
June 1, 1999	62,220,000
December 1, 1999	56,890,000
June 1, 2000	53,480,000
December 1, 2000	48,540,000
June 1, 2001	45,410,000
December 1, 2001	40,870,000
June 1, 2002	38,015,000
December 1, 2002	33,860,000
June 1, 2003	31,250,000
December 1, 2003	27,465,000
June 1, 2004	25,085,000
December 1, 2004	21,655,000
June 1, 2005	19,485,000
December 1, 2005	16,405,000
June 1, 2006	14,415,000
December 1, 2006	11,675,000
June 1, 2007	9,850,000
December 1, 2007	7,450,000
June 1, 2008	5,780,000
December 1, 2008	3,730,000
June 1, 2009	2,200,000
December 1, 2009	520,000
June 1, 2010 and each June 1 and December 1 thereafter	-0-

The amount of PAC Bonds redeemed pursuant to each such mandatory redemption shall be equal to the lesser of, on the date of determination of the redemption amount, (i) the amount of Allocated Prior Contracts Restricted Recoveries (so long as such Allocated Prior Contracts Restricted Recoveries equal at least \$250,000) and (ii) the positive difference between the aggregate principal amount of PAC Bonds Outstanding and the PAC Outstanding Amount for such semiannual period (a "Positive PAC Redemption Amount"). If such mandatory redemption occurs on a day other than a June 1 or December 1, there must be an additional mandatory redemption on the next succeeding June 1 or December 1 if on such June 1 or December 1 there are Allocated Prior Contracts Restricted Recoveries at least equal to \$250,000 and a Positive PAC Redemption Amount.

Mandatory Redemption of Super Sinker Bonds. Such redemption of Super Sinker Bonds may occur at any time, on or after June 1, 1998, at the option of the Department, and must occur on each June 1 and December 1, but only if (i) there are no PAC Bonds Outstanding or there is no Positive PAC Redemption Amount and (ii) there are Allocated Prior Contracts Restricted Recoveries. (The Department is not required to redeem the Super Sinker Bonds, however, unless the Allocated Prior Contracts Restricted Recoveries available to redeem the Super Sinker Bonds equals at least \$250,000.)

Allocated Prior Revenue Bonds Contracts of Purchase. The "Allocated Prior Revenue Bonds Contracts of Purchase" consist of approximately \$163 million aggregate principal amount of the Prior Revenue Bonds Contracts of Purchase financed by the Home Purchase Revenue Bonds, 1986 Series A and 1988 Series A. Such Allocated Prior Revenue Bonds Contracts of Purchase will be so allocated on or before August 1, 1998.

Information Regarding Prepayments

The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Contracts of Purchase—Existing Contracts of Purchase Origination and Principal Repayment Experience." The Contracts of Purchase in such chart include the Allocated Prior Revenue Bonds Contracts of Purchase. However, since the Department expects to substantially reduce the interest rates on all existing Contracts of Purchase, the prepayment experience reflected in the chart may not predict the future behavior of such Contracts of Purchase after the interest rate reduction. To the extent that Allocated Prior Revenue Bonds Contracts of Purchase principal payments occur at a slower rate than that assumed in calculating the PAC Outstanding Amounts, Available Restricted Recoveries will not be sufficient at all dates to provide for redemption of the PAC Bonds pursuant to such schedule. Allocated Prior Revenue Bonds Contract of Purchase principal payments may occur at a faster or slower rate than estimated; accordingly, actual redemption of the PAC Bonds will occur at the times and in the amounts corresponding with actual Allocated Prior Revenue Bonds Contracts of Purchase principal payments.

For certain Revenue Bonds issued or to be issued after 1988, the Internal Revenue Code of 1986, as amended (the "Tax Code") permits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase for only 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a \$250,000 *de minimis* amount.

The Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of Revenue Bonds. See "TAX MATTERS—Other Requirements Imposed by the Code—Recapture Provision." Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of certain Revenue Bonds, for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

General Provisions as to Redemption

The Resolution permits the purchase of Offered Revenue Bonds at public or private sales by the Department or the Trustee. Any Offered Revenue Bonds so purchased may be credited against any required redemption amounts.

The Resolution provides that whenever Offered Revenue Bonds may be redeemed in part within a maturity the Trustee will select the Offered Revenue Bonds to be redeemed by lot in any manner which the Trustee in its sole discretion may determine. However, see "BOOK-ENTRY

ONLY SYSTEM" for a description of DTC's practices regarding selection of beneficial ownership interests in bonds for redemption.

Notice of redemption of any Offered Revenue Bonds to be redeemed will be given by the Trustee for and on behalf of the Department. Each notice of redemption will state the redemption date, the place or places of redemption, the redemption price, if any, the CUSIP number (if any) of the maturity or maturities, and, if less than all of any such maturity is to be redeemed, such other additional information as described in the Resolution. No further interest will accrue on the principal of any Offered Revenue Bonds called for redemption after the redemption date. Notice of redemption will be mailed, not less than fifteen nor more than ninety days prior to the redemption date, to the respective registered owners of any Offered Revenue Bonds designated for redemption at their addresses appearing on the registration books of the Trustee. Notice of redemption will also be provided by mail to certain financial services as provided in the Resolution. No defect in the notice of redemption or mailing thereof (including any failure to mail such notice) to any Bondowner will affect the validity of the redemption proceedings for any other Offered Revenue Bonds.

Mandatory Tender of 1997 Series C Bonds

General. Each 1997 Series C Bond will be subject to mandatory tender (with no right to retain) on its Mandatory Tender Date at a purchase price equal to 100% of the principal amount thereof. "Mandatory Tender Date" means each date on which the 1997 Series C Bonds or any portion thereof are subject to adjustment to a new rate or rates of interest, which date is December 1, 1999, unless the Department designates one or more business days prior thereto on or after December 1, 1998 as the Mandatory Tender Date for all or a portion of the 1997 Series C Bonds. References to "its Mandatory Tender Date" or "the applicable Mandatory Tender Date" with respect to a 1997 Series C Bond shall mean the date on which the interest rate on such Bond is adjusted to a new rate of interest. **This Official Statement is not intended to provide any information with respect to any 1997 Series C Bond after its applicable Mandatory Tender Date.** Payment of the purchase price of 1997 Series C Bonds will be made to the holders thereof upon surrender of their 1997 Series C Bonds. In the event of a failure to remarket all or a portion of such 1997 Series C Bonds subject to mandatory tender on a Mandatory Tender Date, such unremarketed 1997 Series C Bonds will be purchased or redeemed by the Trustee (without further notice to the holders) with moneys available for such purpose and will be cancelled and retired by the Trustee.

The Ninth Supplemental Resolution provides that if the Department designates the Mandatory Tender Date for all or any portion of the 1997 Series C Bonds to be a date other than December 1, 1999, then no later than the 30th day prior to such earlier Mandatory Tender Date (the "Notification Date"), the Trustee will send written notice by first class mail, postage prepaid, to each holder of a 1997 Series C Bond for which such date is its Mandatory Tender Date, stating (i) the Mandatory Tender Date, (ii) that such 1997 Series C Bond will be deemed to be tendered for purchase on such Mandatory Tender Date at a purchase price equal to 100% of the principal amount thereof, (iii) that such 1997 Series C Bond will be purchased or redeemed without further notice on the Mandatory Tender Date, and (iv) that the purchase price or redemption price of each 1997 Series C Bond will be payable by the Trustee upon delivery to the Trustee of such 1997 Series C Bond. So long as all of the 1997 Series C Bonds for which such date is a Mandatory Tender Date are immobilized in the custody of DTC, such notice will be delivered by the Trustee to DTC or its nominee as holder of such 1997 Series C Bonds. DTC is responsible for notifying Participants, and Participants and Indirect Participants are responsible for notifying Beneficial Owners. Neither the Trustee nor the Department is responsible for sending notices to Beneficial Owners or for the consequences of any action or inaction by the Department as a result of the response or failure to respond by DTC or its nominee as holder.

BOOK-ENTRY ONLY SYSTEM

THE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM DTC, AND NEITHER THE DEPARTMENT NOR THE UNDERWRITERS TAKE RESPONSIBILITY FOR THE ACCURACY OR COMPLETENESS THEREOF.

DTC, located in New York, New York, will act as securities depository for the Offered Revenue Bonds. The Offered Revenue Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) ("Cede"). One fully-registered bond certificate will be issued for each of the maturities of the Offered Revenue Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of Offered Revenue Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Revenue Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Revenue Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Revenue Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Revenue Bonds, except in the event that use of the book-entry system for the Offered Revenue Bonds is discontinued.

To facilitate subsequent transfers, all Offered Revenue Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede. The deposit of Offered Revenue Bonds with DTC and their registration in the name of Cede effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Revenue Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Revenue Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to Cede. If less than all of a maturity of the Offered Revenue Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede will consent or vote with respect to Offered Revenue Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Department as soon as possible after the record date. The Omnibus Proxy assigns Cede's consenting or voting rights to those Direct Participants to whose accounts the Offered Revenue Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest on the Offered Revenue Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on a payment date in accordance with their respective holdings shown on DTC's records, unless DTC has reason to believe that it will not receive payment on such payment date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee, or the Department, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Trustee or the Department, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants. **NEITHER THE DEPARTMENT NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO SUCH PARTICIPANTS, TO THE PERSONS FOR WHOM THEY ACT AS NOMINEES WITH RESPECT TO THE OFFERED REVENUE BONDS, OR TO ANY BENEFICIAL OWNER IN RESPECT OF THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT OR INDIRECT PARTICIPANT, THE PAYMENT BY DTC OR ANY DIRECT OR INDIRECT PARTICIPANT OF ANY AMOUNT IN RESPECT OF THE PRINCIPAL OR REDEMPTION PRICE OF OR INTEREST ON THE OFFERED REVENUE BONDS, ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO BONDOWNERS UNDER THE RESOLUTION, THE SELECTION BY DTC OR ANY DIRECT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE OFFERED REVENUE BONDS, OR ANY OTHER ACTION TAKEN BY DTC AS REGISTERED BONDOWNER.**

THE TRUSTEE, AS LONG AS THE DTC BOOK-ENTRY METHOD IS USED FOR THE OFFERED REVENUE BONDS, WILL SEND ANY NOTICE OF PREPAYMENT OR OTHER NOTICES ONLY TO DTC OR ITS NOMINEE. ANY FAILURE OF DTC TO ADVISE ANY PARTICIPANT, OR THE FAILURE OF ANY PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY SUCH NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE PREPAYMENT OF THE OFFERED REVENUE BONDS CALLED FOR PREPAYMENT OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

Conveyance of notices and other communications by DTC to the Participants, by the Participants to Indirect Participants, and by the Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory and regulatory requirements as may be in effect from time to time.

So long as the DTC book-entry method is used for the Offered Revenue Bonds, payments of principal, premium, if any, and interest with respect to the Offered Revenue Bonds will be made by the Trustee only to DTC or its nominee as the registered owner of the Offered Revenue Bonds, and all such payments shall be valid and effective to fully satisfy and discharge the Department's obligations with respect to the principal, premium, if any, and interest with respect to the Offered Revenue Bonds to the extent of the sum or sums so paid. Transfer or crediting of the applicable principal, premium, if any, and interest payments to its Participants is the responsibility of DTC, and to beneficial owners or their nominees is the responsibility of the Participants.

THE DEPARTMENT AND THE TRUSTEE CANNOT AND DO NOT GIVE ANY ASSURANCES THAT DTC, PARTICIPANTS OR OTHERS WILL DISTRIBUTE PAYMENTS WITH RESPECT TO THE OFFERED REVENUE BONDS RECEIVED BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER, OR ANY PREPAYMENT OR OTHER NOTICES, TO THE BENEFICIAL OWNERS, OR THAT THEY WILL DO SO ON A TIMELY BASIS, OR THAT DTC WILL SERVICE AND ACT IN THE MANNER DESCRIBED IN THIS OFFICIAL STATEMENT.

The Department and the Trustee understand that the current "Rules" applicable to DTC are on file with the Securities and Exchange Commission, and that the current "Procedures" of DTC to be followed in dealing with Participants are on file with DTC.

The Department and the Trustee may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Offered Revenue Bond certificates will be printed and delivered. DTC may discontinue providing its services as securities depository with respect to the Offered Revenue Bonds at any time by giving reasonable notice to the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Offered Revenue Bond certificates are required to be printed and delivered. In the event the Department and the Trustee determine not to continue the DTC book-entry only system or DTC determines to discontinue providing its services with respect to the Offered Revenue Bonds and the Department and the Trustee do not select another qualified securities depository, the Trustee shall deliver one or more Offered Revenue Bonds in such principal amount or amounts, in the denominations of \$5,000 or any integral multiple thereof, and may be transferred upon the books of the Trustee by the registered owners, in person or by authorized attorney, upon surrender of the Offered Revenue Bonds at the office of the Trustee, accompanied by delivery of an executed instrument of transfer in a form approved by the Trustee and upon payment of any charges provided for in the Resolution, and the Offered Revenue Bonds may be exchanged for Offered Revenue Bonds of other authorized denominations of the same aggregate principal amount, series and maturity at the office of the Trustee, upon payment of any charges provided for in the Resolution. No transfer or exchange of the Offered Revenue Bonds shall be made by the Trustee during the 15 days next preceding each interest payment date.

The foregoing description of the procedures and recordkeeping regarding the beneficial ownership interests in the Offered Revenue Bonds, payment of principal, premium, if any, and interest with respect to the Offered Revenue Bonds to DTC, the Participants or Beneficial Owners, confirmation and transfers of beneficial ownership interests in the Offered Revenue Bonds and other related transactions by and between DTC, the Participants and the Beneficial Owners is based on information provided by DTC. Accordingly, no representations can be made concerning these matters. The Beneficial Owners should not rely on the foregoing information with respect to such matters, but should instead confirm the same with the applicable Participants.

APPLICATION OF OFFERED REVENUE BOND PROCEEDS

The sources of funds and the uses thereof in connection with the Offered Revenue Bonds, exclusive of accrued interest thereon, after expected transfers and exchanges, are expected to be approximately as set forth below.

	1997 Series A Bonds, 1997 Series B Bonds and 1997 Series C Bonds	1998 Series A Bonds
SOURCES		
Offered Revenue Bond proceeds	\$120,990,000	\$154,065,000
Available amounts in the 1943 Fund.....	102,219,249	12,091,461
	<u>\$223,209,249</u>	<u>\$166,156,461</u>
USES		
Redemption of Prior Bonds ⁽¹⁾	\$120,990,000	\$154,065,000
Deposit to 1997C Revenue Bond Series Proceeds Subaccount ⁽²⁾	100,000,000	0
Deposit to Bond Reserve Account	1,469,300	10,784,550
Costs of issuance	238,135	303,234
Underwriters' compensation.....	511,814	1,003,677
	<u>\$223,209,249</u>	<u>\$166,156,461</u>

(1) Includes principal on Prior Revenue Bonds to be paid or redeemed and principal on certain Veterans G.O. Bonds to be paid within 90 days of the respective dates of issuance of the Offered Revenue Bonds.

(2) Proceeds of the 1997 Series C Bonds will become available to finance New 1997/1998 Revenue Bonds Contracts of Purchase and to deposit into the Bond Reserve Account (if necessary) as the interest rates on such 1997 Series C Bonds are converted to fixed rates to maturity.

THE PROGRAM

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature ("Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 405,000 veterans to purchase farms and homes throughout the State through long term housing and farm loans. The sales of Revenue Bonds and Veterans G.O. Bonds, combined with surplus revenues from borrowers under the Program not needed at any given time to meet the then current bond retirement schedules and operating costs, have provided approximately \$9,710,463,000 for the purchase of farms and homes since Program inception. As of September 30, 1997 there were 38,379 Contracts of Purchase outstanding with a remaining principal balance of \$2,190,214,754. See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Contracts of Purchase—Existing Contracts of Purchase" and "—Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof. The Veterans Code and the Department's implementation thereof are subject to change. The Program is also subject to the Tax Code, as noted below and as discussed in greater detail under "TAX MATTERS."

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code (including recent amendments effective January 1, 1998) allows the Department to finance Contracts of Purchase for

(a) veterans who have served during a period which includes service in one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

The amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. The Department expects these amendments to significantly increase the universe of potential contract holders, and to increase demand for Contracts of Purchase financed with Revenue Bond and Veterans G.O. Bond proceeds.

Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of federal law set forth in the Tax Code, which can limit the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. Applying the current Tax Code separates the Department's lendable moneys into three classes:

(A) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund and certain proceeds of Revenue Bonds and Veterans G.O. Bonds, including certain future issues of

taxable bonds, if any), which can finance Contracts of Purchase for any veteran who qualifies under the Veterans Code (there are no loan eligibility requirements imposed by the federal Tax Code with respect to Contracts of Purchase financed by such moneys). These moneys can finance Contracts of Purchase for all veterans:

(B) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds), which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. (The loan eligibility requirements imposed by the federal Tax Code do not apply to Contracts of Purchase financed by such moneys. These are described under "TAX MATTERS—Federal Tax Matters—Loan Eligibility Requirements Imposed by the Tax Code" and "—Other Requirements Imposed by the Federal Tax Code" (principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements")). These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(C) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bonds proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies the QMB Loan Eligibility Requirements. These proceeds can finance Contracts of Purchase for all veterans.

Allocation of Lendable Moneys. For those veterans seeking financing who would qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department will select the source of funds to use in its sole discretion. The Department's goal is to maximize the availability of Program benefits.

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Tax Code. A Contract of Purchase creates an installment land contract between the Department and the veteran which is analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price."

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is \$250,000 and for farms is \$300,000 (except that the limitation with respect to certain mobile homes in mobile home parks is \$70,000 and except that the maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds, which maximums are adjusted periodically. (No Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds). These Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. These Tax Code limits currently range from \$88,266 to \$313,512. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Tax Code.

The Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size, and range from \$50,000 to \$80,730. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Under amendments to the Veterans Code which become effective January 1, 1998, any veteran who qualifies under the Veterans Code and the Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

The existing Contracts of Purchase are not insured or guaranteed by the Federal Housing Administration, the USDVA, Rural Housing Service or any private mortgage insurer. (But see "THE PROGRAM—Loan Insurance" below for the Department's plans to obtain USDVA guarantees and private primary mortgage insurance for certain Contracts of Purchase.)

The terms of the Contracts of Purchase are substantially identical regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to recapture provisions. See "TAX MATTERS—Federal Tax Matters—Loan Eligibility Requirements Imposed By the Tax Code—Requirements as to Assumptions" and "—Other Requirements Imposed by the Tax Code—Recapture Provision."

Since the number and value of (a) Contracts of Purchase relating to farms and mobile homes, and (b) Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes, unless otherwise indicated. See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Contracts of Purchase—Existing Contracts of Purchase."

Origination. The Veterans Code, in most cases, requires a veteran to make an initial payment of at least five percent of the selling price of the property, except that where the purchase price is \$60,000 or less, the initial payment must be at least three percent of the selling price of the property. (The Department in the future may seek legislative changes to modify the initial payment requirement to more closely resemble those of the USDVA guaranty program). The balance of the purchase price (including USDVA guaranty fees) may be amortized over a period fixed by the Department, not exceeding 40 years for single-family homes. Substantially all existing Contracts of Purchase are for a term of 30 years. It is the present policy of the Department to limit the term of Contracts of Purchase to a maximum of 30 years.

The Veterans Code permits the Department to finance home and property improvements for veterans with existing Contracts of Purchase. Each veteran receiving financing for home and property improvements executes an additional Contract of Purchase with respect to such financing. The additional Contract of Purchase requires payment of the financed amount, bears interest at the same rate as the existing Contract of Purchase on the property, and is payable over a maximum term which is based upon the principal amount financed. In no event can the final payment date for any such additional Contract of Purchase be more than 40 years from the origination of the existing Contract of Purchase. The maximum home improvement loan for those veterans who qualify only for Qualified Mortgage Bond Proceeds is \$15,000 over the term of the Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of \$50,000. Subsequent home improvement loans may be granted, if funds are available, so long as there is only one outstanding home improvement loan to such veteran outstanding at any time. See "TAX MATTERS."

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self-help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not expect Contracts of Purchase which finance home construction to be eligible for USDVA guaranty. Once the construction is completed, however, the Department expects to submit such Contracts of Purchase for USDVA guaranty.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria, which are subject to periodic Department review and modification, are similar to the criteria of commercial lenders and are intended to determine the veteran's willingness and ability to make payments under the Contract of Purchase. When the Department begins its participation in the USDVA guaranty program, the Department will conform its lending criteria to those of the USDVA for all Contracts of Purchase, including those not eligible for USDVA guaranties.

Servicing. Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month (usually the 18th day of the month). A \$10 penalty late charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 5.5% of the principal and interest portion of the installment, in addition to the interest which continues to accrue. The Department may revise these fees if the Department considers such revisions to be appropriate.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. As a result, a small number of Contracts of Purchase have maximum loan periods in excess of 30 years. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above.

Prepayments. The Department currently imposes on Contracts of Purchase a prepayment charge of 2% of the purchase price to the veteran if the Contract of Purchase is paid in full within two years of its origination date. After the two-year period, the veteran may prepay without charge any or all installments still remaining unpaid. The Department will eliminate this prepayment charge by March 1, 1998 in order to conform to USDVA guaranty program requirements.

Cancellations and Delinquencies. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights

under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it. All proceeds from a sale are first applied to pay any bonds used with respect to the repossessed property, with any excess deposited in the 1943 Fund.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be cancelled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; *however*, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved and is marketed through the Department's applicable field office. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). Also, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding.

See Exhibit D—"CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA—Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. At present, veterans are charged interest on their Contracts of Purchase at a rate which is set at least annually by the Department, with the review of the Board and the Veterans' Finance Committee of 1943. Most Contracts of Purchase currently bear interest at a rate of 8.0%, although, as discussed under "PLAN OF FINANCE AND PROGRAMMATIC CHANGES," the Department expects to lower such interest rate. The Veterans Code currently

requires that all Contracts of Purchase bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for Contracts of Purchase can be changed at any time and as often as necessary. The effective date of a higher rate of interest on Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Veterans' Finance Committee of 1943 that such additional action is necessary to protect the solvency of the 1943 Fund.

The Department plans in 1998 to seek legislative changes which (i) will eliminate the uniform interest rates requirement for future Contracts of Purchase and (ii) will allow the Department to establish fixed interest rates for such Contracts of Purchase. See "PLAN OF FINANCE AND PROGRAMMATIC CHANGES."

Loan Insurance

As discussed above under "PLAN OF FINANCE AND PROGRAMMATIC CHANGES," the Department is considering several programmatic changes, including obtaining loan insurance from private primary mortgage insurers for certain existing Contracts of Purchase with high loan-to-value ratios and USDVA guaranties for new Contracts of Purchase with high loan-to-value ratios. Although the Department expects to obtain such USDVA loan guaranties and primary mortgage insurance (as described below), there can be no assurances that it will be able to do so on terms and at a cost acceptable to the Department.

USDVA Guaranty Program. The Department has been approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA. As a result, the Department expects to originate each future Contract of Purchase with a loan-to-value ratio of 80% or higher with a USDVA guaranty, if such Contract of Purchase is otherwise eligible for USDVA guaranty.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and thirty-two days' duration. While the USDVA program does not require a down payment from the purchaser, the Veterans Code currently requires down payments, although the Department expects to seek legislative changes to modify this requirement. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of the veteran's available entitlement (a maximum of \$36,000, or if the original loan amount exceeds \$144,000, a maximum of \$50,750), or (1) 50% of the original loan amount if such amount does not exceed \$45,000, (2) \$22,500 if the original loan amount is between \$45,000 and \$56,250, (3) the lesser of \$36,000 or 40% of the original loan amount, if such amount is between \$56,250 and \$144,000, or (4) the lesser of \$50,750 or 25% of the original loan amount, if such amount is in excess of \$144,000. The liability on the guaranty is reduced or increased pro rata with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Extended periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security.

Self Insurance Mortgage Loss Set-Aside. The Department expects to establish a mortgage loss fund within the 1943 Fund funded by mortgage insurance charges paid by veteran recipients of Contracts of Purchase that do not qualify for USDVA guaranties or that have loan amounts that exceed USDVA coverage.

Primary Mortgage Insurance. The Department has received indications of interest from third party private mortgage insurers to provide primary mortgage insurance with respect to certain existing Contracts of Purchase with loan-to-value ratios of 80% or higher. Such primary mortgage insurance would cover aggregate actual losses following property disposition above a specified self-insured level. If it is determined to be cost effective, the Department expects to purchase such insurance effective early 1998. To date, however, the Department has neither obtained such insurance nor determined which Contracts of Purchase are to be subject to such primary mortgage insurance, the provider of such insurance, the level of insurance coverage, and the size of the self-insurance threshold.

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policies have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or by insurance companies selected by the Department.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments, up to a deductible. The Master Policy described below (the "Master Policy") provides coverage in excess of the deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by a commercial insurer.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover the costs of providing the insurance coverage including the insurance premium due under the Master Policy described below with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to \$1,500,000 per occurrence or \$12,000,000 per policy year. If the total losses from a single occurrence exceed \$1,500,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed \$12,000,000, liability for the excess will be covered under the Master Policy. The Master Policy will expire on October 31, 1998.

The Master Policy is an all-physical loss form. Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to \$1.22 per \$100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

Disaster Indemnity Plan. The Department provides disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of \$250 caused by flood, earthquake or other perils not covered by the fire and hazard insurance policy (not otherwise excluded). After January 1, 1998, the deductible for flood losses will increase to \$500 and the

deductible for earthquake losses will increase to \$500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of nineteen insurance companies for a total of \$50,000,000 of coverage with a \$4,000,000 annual deductible. The 1997 to 1998 annual premium for this coverage is \$2,735,175.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of \$1.35 per \$1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 1997 was \$10,525,000.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency (FEMA) covering all properties financed by Contracts of Purchase that are located in designated flood zones.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses, incurred by the 1943 Fund (See "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION"), the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program by a life and disability insurance plan (the "Life and Disability Plan") provided by PM Group Life Insurance Company ("PM Group"). The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented. Benefits are equal to the amount of the monthly loan payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment, dies, or his contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator agreement and are shown in the financial statements for the 1943 Fund as investments with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. (See "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION".)

The current Life and Disability Plan has an average monthly premium payment to PM Group of \$1.1 million, with an average monthly administrative fee payable to the Department of approximately \$60,000. All veterans currently obtaining new Contracts of Purchase must apply to PM Group for coverage and those veterans who meet the PM Group criteria, and are under age 62, are insured through the Life and Disability Plan.

The life insurance benefit provides for payment of 100% of the loan balance at the time of the insured's death. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months.

After reviewing the current insurance plan, a Request for Proposal for a revised life and disability insurance plan was issued. As a result, the Department has selected a new commercial insurance plan, which, upon implementation, will result in reduced premiums and longer-term rate stabilization. Major elements of the life and disability coverage will continue unchanged for all currently insured up to age 60. Life insurance coverages for those currently insured contract holders in the program over age 60 will continue but will be limited to the loan amount or a lesser value of \$75,000, at age 60, reducing to \$5,000 after age 80. A new insurance protection plan for new loan holders will be implemented. It will continue to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health

of the individual loan applicant. All new loan applicants must apply and must be provided the minimum life insurance coverage. Disability coverage, for a period up to two years, will be optional for new loanholders. Additional, full coverage, life insurance may also be purchased as an option by new contract holders. Other optional insurance coverages will be available. The new plan will be an experience rate plan subject to annual rating reviews of insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department will establish a one-time \$5 million rate stabilization reserve, which the Department will retain as part of the 1943 Fund. The new plans of insurance coverage will be effective February 1, 1998.

SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

The following is a summary of certain provisions of the Resolution. These summaries do not purport to be comprehensive and reference should be made to the Resolution for a full and complete statement of its provisions.

Resolution to Constitute Contract (Section 101)

In consideration of the purchase and acceptance of any and all of the Bonds issued under the Resolution by those who shall own the same from time to time, the Resolution shall be deemed to be and shall constitute a contract between the Department, the Trustee and the owners of the Bonds, and the pledges made in the Resolution and the covenants and agreements in the Resolution set forth to be performed by the Department or the Trustee shall be for the equal benefit, protection and security of the owners of any and all of the Bonds, all of which, without regard to the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of any of the Bonds over any other of the Resolution, *except* as expressly provided in or permitted by the Resolution or by the applicable Series Resolution.

Pledge Effected by the Resolution (Section 102)

For the purpose of fixing and declaring the terms and conditions upon which the Bonds are to be issued, executed, delivered, secured and accepted by the owners of the Bonds, and in order to secure the payment of all Bonds at any time issued and Outstanding under the Resolution and the interest thereon according to their tenor, purport and effect, and in order to secure the performance and observance of all the covenants, agreements and conditions therein and in the Resolution contained, the Department has adopted the Resolution, has pledged, conveyed and assigned, and, subject to the subordination provisions in favor of other debt holders of the Department contained in the definition in the Resolution of Pledged Property, does by the Resolution pledge, convey and assign the Pledged Property to the Trustee as security for the payment of the principal of, including redemption premium, if any, on the Bonds and the interest thereon for the equal and proportionate benefit and security, from time to time, of the owners of the Bonds, without preference, priority or distinction as to lien or otherwise, *except* as otherwise provided in the Resolution or as provided in an applicable Series Resolution, of any one Bond over any other Bond, by reason of priority in the issue, sale or negotiation of the Resolution or otherwise, all in accordance with the terms of the Resolution.

Definitions (Section 103)

In the Resolution and any resolution supplemental to the Resolution the following terms shall have the following meanings:

"*Account*" means an Account (or any subaccount therein) created by or pursuant to the Resolution or a Series Resolution.

"*Accountant*" means an independent certified public accountant or firm of independent certified public accountants selected by the Department, who may be the accountant or firm of accountants who regularly audit the books of the Department.

"*Accrued Debt Service*" means, as of any date of determination and, as the context of the Resolution requires, with respect to all Bonds and/or all Veterans General Obligation Bonds, the sum of:

(a) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) hereof) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(b) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(c) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans General Obligation Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

"*Additional Bonds*" means any additional Bonds issued pursuant to Section 209 of the Resolution.

"*Amortized Value*" means the purchase price of securities, excluding accrued interest, plus an amortization of any discount or less an amortization of any premium included in the purchase price. The premium or discount shall be amortized on an actuarial basis, such that the Amortized Value at any time equals the price at which the yield on a security equals the yield of such security as of its original purchase. In the case of an Investment Obligation callable at the option of the issuer thereof, the original yield and Amortized Value shall be computed on the assumption that, (i) for securities purchased at a premium, such security is redeemed as of the first possible redemption date, provided, that after such redemption date, such value of the Investment Security shall be computed at par, or (ii) for securities purchased at a discount, such security is held to maturity.

"*Applicable Fund Parity Percentage*" means 50% or such other percentage set forth in the Program Operating Procedures.

"*Appreciated Amount*" means with respect to a Deferred Interest Bond, (i) as of any date of computation with respect to any Deferred Interest Bond up to the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, an amount equal to the initial principal amount of such Deferred Interest Bond plus the interest accrued on such Deferred Interest Bond from the date of original issuance of such Deferred Interest Bond to the applicable interest payment date next preceding the date of computation or the date of computation if an applicable interest payment date, such increased amount to accrue at the rate per annum set forth in the Series Resolution authorizing such Deferred Interest Bond, compounded on each applicable interest payment date, plus, if such date of computation shall not be an applicable interest payment date, a portion of the difference between the Appreciated Amount as of the immediately preceding applicable interest payment date (or the date of original issuance if the date of computation is prior to the first applicable interest payment date

succeeding the date of original issuance) and the Appreciated Amount as of the immediately succeeding applicable interest payment date, calculated based upon an assumption that the Appreciated Amount accrues in equal daily amounts on the basis set forth in the Series Resolution authorizing such Deferred Interest Bond; and (ii) as of any date of computation on and after the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, the Appreciated Amount as of such current interest payment commencement date.

"Authorized Representative" or *"Authorized Officer"* means the Secretary of Veterans Affairs, Undersecretary of Veterans Affairs, Deputy Secretary of Operations, Deputy Secretary of Administration or any other authorized representative as from time to time may be designated by the Secretary in writing to the Trustee as authorized to act under the Resolution on behalf of the Department.

"Bond Act" means the Veterans' Revenue Debenture Act of 1970 (constituting Chapter 7 of Division 4 of the Veterans Code), as now in effect and as it may from time to time hereafter be amended or supplemented.

"Bondowner" or *"owner of Bonds"* or *"Holder"* or *"Bondholder"* means the registered owner of any registered Bond.

"Bond Registrar" means the Trustee as the party responsible for maintenance of the Bond registration books of the Department pursuant to Section 208 of the Resolution.

"Bond Reserve Account" means the Bond Reserve Account established pursuant to Section 401 of the Resolution.

"Bond Reserve Requirement" means, as of any particular date of calculation, an amount equal to the aggregate of all amounts established for all Series of Bonds Outstanding in the Series Resolutions authorizing the issuance of such Bonds, at least equal in the aggregate to three per centum (3%) of the aggregate Outstanding principal amount of the Bonds with interest rates fixed to the maturity thereof.

"Bonds" means Revenue Bonds.

"Cash Equivalent" means a Letter of Credit, Insurance Policy, Surety, Guarantee or other Security Arrangement (as defined and provided for in a Series Resolution providing for the issuance of Bonds or in a Supplemental Resolution), provided by an institution which has received a rating of its claims paying ability from each of the Rating Agencies at least equal to the then existing respective rating on the Bonds or whose unsecured debt securities are rated at least the then existing respective rating on the Bonds (or the highest rating of short-term obligations if the Cash Equivalent is a short-term instrument) by the Rating Agencies.

"Cash Flow Statement" means a Cash Flow Statement conforming to the requirements of Section 607 of the Resolution.

"Certificate of the Department" means an instrument in writing signed by an Authorized Representative.

"Committee" means the Veterans' Debenture Finance Committee created by the Bond Act.

"Contract of Purchase" means any contract of purchase entered into by the Department and a veteran or other eligible person covering any property (whether residential or otherwise) purchased or acquired by the Department with moneys in the 1943 Fund or any other obligation representing a program investment of such moneys irrespective of the form of such obligation.

"Costs of Issuance" means all items of expense payable or reimbursable directly or indirectly by the Department and related to the authorization, sale, issuance and remarketing of the Bonds, as certified by an Authorized Representative.

"Credit and Liquidity Support Expenses" means, with respect to a Series of Bonds or a series of Veterans General Obligation Bonds (as the context requires), as set forth in a Series Resolution or Supplemental Resolution, or resolution of issuance governing such series of Veterans General Obligation Bonds, respectively, the amounts necessary to pay any fees and reimbursement in connection with tender option features, letters of credit, standby bond purchase agreements, bond insurance and other forms of credit and liquidity support related thereto.

"Debt Service Year" means the year beginning on the second day of October and ending on the first day of October in the next succeeding year, or any other twelve-month period hereafter selected and designated as such in the Program Operating Procedures.

"Deferred Interest Bond" means any Bond designated as such by the Series Resolution authorizing the issuance of such Bond.

"Department Request" means a written request or direction of the Department signed by an Authorized Representative.

"Excess Revenues" means, as of any date of calculation, the amount of all Revenues held in the Revenue Account in excess of Accrued Debt Service (as adjusted for any contemplated use of Revenues during the relevant period).

"Expenses" means any moneys required by the Department to pay, or to be set aside to pay, the expenses of the Trustee and any expenses which the Department may lawfully pay from the 1943 Fund (whether or not related to the Bonds), except (i) as limited with respect to any Series of Bonds by the applicable Series Resolution, and (ii) that Credit and Liquidity Support Expenses shall not be included in the definition of "Expenses"; *provided, however*, that such expenses related to Cash Equivalents shall not be excluded.

"Fiscal Year" means the year beginning on the first day of July and ending on the last day of June in the next succeeding year, or any other twelve-month period hereafter selected and designated as the official fiscal year period of the Department.

"Fitch" means Fitch IBCA, Inc., and includes any successor thereto.

"Fund Parity" means, on any determination date, (A) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established hereunder, and (ii) the aggregate Outstanding principal amount of all Bonds and all Veterans General Obligation Bonds (plus accrued interest) reduced by (B) allowances and reserves for loss coverage on Contracts of Purchase, loss coverage on properties subject to Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures.

"Government Obligations" means bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

"Investment Obligations" means, any of the following which at the time of purchase are legal investments under the laws of the State of California for moneys held under the Resolution and then proposed to be invested therein:

(i) Government Obligations;

(ii) Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Banks,

stock, bonds, debentures and other obligations of the Government National Mortgage Association or the Federal National Mortgage Association established under the National Housing Act as amended, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended;

(iii) interest-bearing demand or time deposits in banks or savings and loan associations, which, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or which are issued by an institution, the senior unsecured debt of which is rated in one of the top two rating categories of a Rating Agency;

(iv) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or which are issued by an institution the senior unsecured debt of which is rated in one of the top two rating categories by a Rating Agency;

(v) repurchase agreements backed by or related to obligations described in (i) or (ii) above with any institution whose unsecured debt securities are rated, or which agreements are rated, at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency;

(vi) (1) investment agreements, secured (by collateralization, guaranty or otherwise) or unsecured, with any institution, or fully guaranteed by any institution, whose unsecured debt securities are rated at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency, or (2) any investment agreement that is secured (by collateralization, guaranty or otherwise), to such extent that the investment agreement itself is the subject of such a rating or the Bonds are the subject of written confirmation from a Rating Agency that investment of amounts in such an investment agreement will not cause the outstanding rating of the Bonds by such Rating Agency to be withdrawn, downgraded or suspended;

(vii) commercial paper (having original maturities of not more than 180 days) rated in the highest rating category by a Rating Agency;

(viii) direct and general obligations of or obligations unconditionally guaranteed by any state or political subdivision thereof, the payment of the principal of and interest on which the full faith and credit of the state or such political subdivision is pledged, and certificates of participation in any such obligations (which obligations may be subject to annual appropriations), which obligations or certificates of participation, respectively, are rated at least equal to the then existing rating of the Bonds by a Rating Agency;

(ix) investments in any mutual fund the portfolio of which is limited to Investment Obligations, including any proprietary mutual fund of the Trustee or co-Trustee for which the Trustee or co-Trustee or an affiliate is investment advisor or provided other services to such mutual fund and receives reasonable compensation for such services (and if such mutual fund consists solely of Government Obligations, then such fund will constitute "Government Obligations" for the purposes of the Resolution);

(x) obligations of any state, political subdivision, political corporation or agency, the payment of principal, redemption price, if any, and interest on which is irrevocably secured by Government Obligations; and

(xi) deposits in the Surplus Money Investment Fund in the Treasury of the State.

Provided, that it is expressly understood that the definition of Investment Obligations shall be, and be deemed to be, expanded, or new definitions and related provisions shall be added to the Resolution by a Supplemental Resolution adopted and filed in accordance with Section 1001(j) of the Resolution thus permitting investments with different characteristics from those permitted which the Department deems from time to time to be in the interests of the Department to include as Investment Obligations.

For purposes of the definition, "institution" means an individual, partnership, corporation, trust or unincorporated organization, or a government or agency, instrumentality, program, account, fund, political subdivision or corporation thereof.

If the rating of any Investment Obligation purchased pursuant to the Resolution is downgraded, suspended or withdrawn by any Rating Agency, the Trustee is not required to sell such Investment Obligation but may retain the same hereunder.

"Liquidation/Insurance Proceeds" means amounts representing proceeds of (1) the sale or other disposition of any property subject to any Contract of Purchase, whether upon cancellation of said Contract of Purchase (on account of default or any other cause) or for any other cause, exclusive of amounts so recovered and required by law, contract or resolution of the Department to be otherwise applied, and (2) compensation for losses incurred with respect to the property subject to any Contract of Purchase from the proceeds of condemnation, title insurance, hazard insurance, or primary or pool insurance of the Contracts of Purchase (including Veterans Administration guaranties), exclusive of amounts recovered in respect of such losses to the extent required to be otherwise applied pursuant to the applicable law, contract or resolution of the Department.

"Loan Loss Account" means the Loan Loss Account established pursuant to Section 401 of the Resolution.

"Loan Loss Requirement" means, as of any particular date of calculation, an amount established in the current Cash Flow Statement which, when added to the Bond Reserve Requirement, shall not exceed ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding or such larger amount as may be provided in a Supplemental Resolution adopted pursuant to Section 1001(m) of the Resolution.

"Monthly Debt Service Requirement" means, as of any date of determination, one-twelfth (1/12) of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

"Moody's" means Moody's Investors Service, Inc., and includes any successor thereto.

"1943 Fund" means the Veterans' Farm and Home Building Fund of 1943, established in the Treasury of the State by Section 988 of the Veterans Code.

"Outstanding Bonds" means, as of any date, all Bonds theretofore authenticated and delivered by the Trustee under the Resolution, *except*:

- (a) any Bond deemed paid in accordance with Section 411(b) of the Resolution;
- (b) any Bond cancelled by, or delivered for cancellation to, the Trustee because of payment at maturity or redemption or purchase prior to maturity;
- (c) any Bond deemed paid in accordance with the provisions of Section 303 of the Resolution;
- (d) any Bond deemed paid in accordance with the provisions of Section 1101 of the Resolution; and

(e) any Bond in lieu of or in substitution for which another Bond shall have been authenticated and delivered pursuant to Section 211 of the Resolution, unless proof satisfactory to the Trustee is presented that any Bond for which a Bond in lieu thereof or in substitution therefor shall have been authenticated and delivered is held by a bona fide purchaser, as that term is defined in Article Eight of the Uniform Commercial Code of the State, as amended, in which case both the Bond so substituted and replaced and the Bond or Bonds authenticated and delivered in lieu thereof or in substitution therefor shall be deemed Outstanding.

"Pledged Property" means (a) an undivided interest in the assets of the 1943 Fund, other than any GO Bond Series Bond Proceeds Subaccount, which undivided interest shall be secondary and subordinate to the rights of the holders of Veterans General Obligation Bonds to receive payment of debt service thereon from amounts in the 1943 Fund under any general obligation veterans bond act, (b) any amounts held in the Bond Reserve Account, and (c) any amounts in the Loan Loss Account, *except* amounts in any Rebate Account and except that the pledge established in a Series Resolution may be limited in purpose and time, as set forth in the Series Resolution.

"Primary Contract of Purchase Coverage" means coverage in the form of primary mortgage insurance, guaranty (including by United States Department of Veterans Affairs guaranty) or otherwise of loss from Contract of Purchase defaults as provided in the Program Operating Procedures.

"principal" means (a) as such term references the principal amount of a Deferred Interest Bond or Deferred Interest Bonds, the Appreciated Amount thereof, and (b) as such term references the principal amount of any other Bond or Bonds, the principal amount at maturity of such Bond or Bonds.

"Proceeds Account" means the Proceeds Account established pursuant to Section 401 of the Resolution.

"Program" means the finance program of the Department pursuant to which the Department will issue the Bonds and Veterans General Obligation Bonds and apply the proceeds thereof to finance Contracts of Purchase.

"Program Acts" means the Veterans' Farm and Home Purchase Act of 1943 (constituting Article 3 of Chapter 6 of Division 4 of the Veterans Code) and the Veterans' Farm and Home Purchase Act of 1974 (constituting Article 3.1 of Chapter 6 of Division 4 of the Veterans Code), as now in effect and as they may from time to time hereafter be amended or supplemented.

"Program Operating Procedures" means, at any time, the Department's program operating procedures governing the discretionary activities by the Department under the Resolution, in the then current form, as described in Section 606 of the Resolution.

"Rating Agency" means, at any time, any bond rating agency, including Fitch, Moody's and S&P, that shall have rated any of the Bonds at the request of the Department and shall be maintaining ratings on such Bonds at such time.

"Rating Confirmation" means, with respect to any action or financial condition described in the Resolution, written confirmation from each of the Rating Agencies that the taking of such action or the existence of such financial condition shall not cause the outstanding ratings by such respective Rating Agencies of all Bonds which are not rated based solely on the credit of a bond insurer or other guarantor to be withdrawn, downgraded or suspended.

"Rebate Account" means any Account of that name established by the Department pursuant to Section 401(c) of the Resolution.

"Redemption Price" means, with respect to a Bond or portion thereof, the portion of the principal amount of such Bond or portion plus the applicable premium, if any, payable upon redemption thereof in the manner contemplated in accordance with its terms pursuant to the provisions of the Resolution and any Series Resolution.

"Restricted Recoveries" means, as set forth or referenced in the Series Resolution authorizing a Series of Bonds or in a resolution of issuance authorizing a series of Veterans General Obligation Bonds, or as otherwise designated in the Program Operating Procedures, that portion of prepayments and scheduled repayments of principal on Contracts of Purchase financed (directly or indirectly) by or credited to such Series of Bonds or series of Veterans General Obligation Bonds, respectively, to the extent such amounts are required by the Tax Code or by the terms of such Series Resolution or resolution of issuance, respectively, to be applied to redemption of Bonds or Veterans General Obligation Bonds.

"Revenue Account" means the Revenue Account established pursuant to Section 401 of the Resolution.

"Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the Revenue Account pursuant to Section 502 of the Resolution, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account or the Loan Loss Account, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any Series Resolution.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., and includes any successor thereto.

"Series Certificate" means a Certificate of the Department which shall be dated as of the date of sale and shall be executed (or re-executed in final form) and delivered on the date of issuance of the applicable Series of Bonds.

"Series Proceeds Subaccounts" means, collectively, the Revenue Bond Series Proceeds Subaccounts and the GO Bond Series Proceeds Subaccounts.

"Series Recycling Subaccounts" means, collectively, the Revenue Bond Series Recycling Subaccounts and the GO Bond Series Recycling Subaccounts.

"Series Resolution" means a supplemental resolution of the Committee authorizing the issuance of a Series of Bonds and including any Series Certificate delivered pursuant thereto.

"Series Restricted Recoveries Subaccounts" means, collectively, the Revenue Bond Series Restricted Recoveries Subaccounts and the GO Bond Series Restricted Recoveries Subaccounts.

"Series Revenue Subaccounts" means, collectively, the Revenue Bond Series Revenue Subaccounts and GO Bond Series Revenue Subaccounts.

"State" means the State of California.

"Supplemental Contract of Purchase Coverage" means the coverage, if any, of loss from Contract of Purchase defaults provided in the Program Operating Procedures which supplements any Primary Contract of Purchase Coverage.

"Tax Code" means applicable provisions of the Internal Revenue Code of 1954, as amended, and the Internal Revenue Code of 1986, as amended, and the applicable regulations thereunder.

"Veterans Debenture Fund" means the Veterans Debenture Revenue Fund established in the Treasury of the State by Section 1003.11 of the Veterans Code.

"Veterans Code" means the Military and Veterans Code of the State of California.

"Veterans General Obligation Bonds" means, as of any given time, general obligation bonds of the State the proceeds of which were required to be deposited in the 1943 Fund (or returned to the General Fund or in the Pooled Money Investment Account in the State Treasury in repayment of amounts withdrawn from said General Fund or the Pooled Money Investment Account and deposited in the 1943 Fund) and which are at such given time outstanding.

Miscellaneous Definitions (Section 104)

Unless the context shall otherwise indicate, words which import the singular shall include the plural, and words which import the plural shall include the singular. The word "person" shall mean any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof. The words "of the Resolution", "herein", "hereto", "by the Resolution" and "hereunder" refer to the entire Resolution. The words "interest payment date" mean with respect to any Series of Bonds, the interest payment date(s) established in the applicable Series Resolution, regardless of whether the referenced Bonds are interest-bearing or not.

Any reference to a rating category shall mean the category published by a Rating Agency without reference to numbered or lettered annotations or pluses and minuses.

Authentication of Bonds (Section 205)

Only such of the definitive Bonds as shall have endorsed thereon a certificate of authentication substantially in the form set forth in the applicable Series Resolution, duly executed by the Trustee, shall be entitled to any benefit or security under the Resolution. No definitive Bond shall be valid or obligatory for any purpose *unless* and until such certificate of authentication shall have been duly executed by the Trustee, and such certificate of the Trustee upon any such Bond shall be conclusive evidence that such Bond has been duly authenticated and delivered under the Resolution. The Trustee's certificate of authentication on any definitive Bond shall be deemed to have been duly executed if signed by an authorized officer of the Trustee, but it shall not be necessary that the same officer sign the certificate of authentication on all of the Bonds that may be issued under the Resolution at any one time.

Exchange of Bonds (Section 206)

Subject to, and in accordance with, Section 207 of the Resolution, Bonds, upon surrender thereof at the principal office of the Trustee in Sacramento California, together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee, may, at the option of the registered owner thereof, be exchanged for an equal aggregate principal amount of Bonds of like tenor and of the same Series (and subseries, if applicable) and maturity, bearing interest at the same rate, of any denomination or denominations authorized by the Resolution.

Negotiability, Registration and Registration of Transfer of Bonds (Section 207)

The transfer of any Bond may be registered only upon the books kept for the registration of, and registration of transfers of, Bonds upon surrender thereof to the Trustee together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee. Upon any such registration of transfer of a Bond, the Department shall execute and the Trustee shall authenticate and deliver in exchange for such Bond a new Bond or Bonds, registered in the name of the transferee, in any denomination or denominations authorized by the Resolution, in an aggregate principal amount equal to the principal amount of such Bond of like tenor and of the same Series (and subseries, if applicable) and maturity and bearing interest at the same rate.

Issuance of the Bonds (Section 209)

Each Series Resolution authorizing the issuance of a Series of Bonds shall specify and determine:

- (a) The authorized principal amount of such Series of Bonds;
- (b) The purposes for which such Series of Bonds are being issued which shall be one or more of the following purposes: (i) the financing of Contracts of Purchase, (ii) the making of such deposits in amounts, if any, required by the Resolution or the Series Resolution to be paid into various Accounts or the direct payment of Costs of Issuance, or (iii) the refunding of all or any part of the Bonds of any Series (including any Bonds not deemed Outstanding under the Resolution pursuant to Section 411(b)) or, to the extent permitted by law, Veterans General Obligation Bonds, including the payment of any redemption premium thereon (or premium, to the extent permitted by law, included in the purchase price if purchased in lieu of redemption);
- (c) The maturity date or dates, the amounts of each maturity, and the interest payment dates of the Bonds of such Series;
- (d) The interest payment dates, and rate or rates, of the Bonds of such Series or method of determining the same;
- (e) The denomination or denominations of, and the manner of dating, numbering and lettering the Bonds of each Series;
- (f) In the case of Term Bonds, if any, provision for Mandatory Sinking Account Payments;
- (g) The Redemption Price or Redemption Prices, if any, the time or times and the terms and conditions upon which the Bonds of such Series may be redeemed prior to their maturities, including without limitation the method of selection for redemption as among maturities;
- (h) The amounts to be deposited from the proceeds of such Series of Bonds in the Accounts created and established by the Resolution and the Series Resolution;
- (i) That *notwithstanding* any other provision of the Series Resolution, upon issuance, sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Bond Reserve Account so that the amount in such fund shall be at least equal to the Bond Reserve Requirement calculated immediately after the delivery of such Series of Bonds;
- (j) That *notwithstanding* any other provision of the Series Resolution, upon sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Loan Loss Account so that the amount in such fund shall be at least equal to the Loan Loss Requirement calculated immediately after the delivery of such Series of Bonds;
- (k) The manner in which Bonds of such Series are to be sold and provisions for the sale thereof;
- (l) The form of any credit enhancement or liquidity support for such Series of Bonds; and
- (m) Any other provisions deemed advisable by the Department not in conflict with the provisions of the Resolution.

Said Bonds shall be executed substantially in the form and manner set forth in the Resolution and shall be deposited with the Trustee for authentication, but before said Bonds shall be authenticated and delivered by the Trustee, there shall be on file with the Trustee the following:

(a) A copy, duly certified by an Authorized Representative, of the Resolution and the Series Resolution for such Series of Bonds;

(b) A Certificate of the Department to the effect that no Event of Default shall have occurred and then be continuing;

(c) An opinion of nationally recognized bond counsel stating in the opinion of such counsel that (i) the Resolution and the applicable Series Resolution have been duly adopted and are valid and binding upon the Department and (ii) said Bonds are valid and legally binding special obligations of the Department secured in the manner and to the extent set forth in the Resolution and the applicable Series Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein;

(d) A Cash Flow Statement conforming to the requirements of Section 607 of the Resolution;

(e) With respect to refunding Bonds, a certificate of an Authorized Representative stating that the proceeds (excluding accrued interest but including any premium) of such refunding Bonds, together with any moneys to be withdrawn from the Bond Reserve Account by the Trustee, and any other moneys which have been made available to the Trustee for such purposes, and the principal of and the interest on the investment of such proceeds or any such moneys, will be not less than an amount sufficient to pay the principal of and the redemption premium, if any, on the Bonds to be refunded and the interest which will become due and payable on or prior to the date of their payment or redemption, the expenses in connection with such refunding and to make any required deposits to the Bond Reserve Account and the Loan Loss Account and specifying transfers, if any, from the Series Proceeds Subaccount applicable to the Series of Bonds to be refunded and the refunding Bonds;

(f) With respect to refunding Bonds, if all or part of the refunded Bonds are to be redeemed prior to maturity, irrevocable instructions from an Authorized Representative of the Department to the Trustee to redeem the applicable Bonds; and

(g) a Rating Confirmation;

(h) A request and authorization to the Trustee on behalf of the Department, signed by an Authorized Representative, to authenticate and deliver the Bonds to the purchaser or purchasers therein identified upon payment to the Trustee for the account of the Department of the purchase price therefor.

When the documents mentioned in clauses (a) to (h), inclusive, of Section 209 shall have been filed with the Trustee and when the Bonds described in the Series Resolution mentioned in clause (a) above shall have been executed and authenticated as required by the Resolution, the Trustee shall deliver such Bonds at one time to or upon the order of the purchaser or purchasers named in the request and authorization mentioned in clause (h) of this Section, but only upon payment to the Trustee of the purchase price of said Bonds. The Trustee shall be entitled to rely upon such request and authorization as to the amount of such purchase price.

Simultaneously with the delivery of such Bonds the Trustee shall deposit or credit the proceeds of said Bonds into the applicable Revenue Bond Series Proceeds Subaccount of the Proceeds Account. Unless otherwise provided in the applicable Series Resolution, the Trustee shall apply such proceeds together with any other available funds, as follows:

(i) an amount shall be transferred to and deposited to the credit of the Bond Reserve Account such that the amount on deposit in such Account will at least equal the Bond Reserve Requirement (with respect to refunding Bonds, after giving effect to the refunding);

(ii) an amount shall be transferred to and deposited to the credit of the Loan Loss Account such that the amount on deposit in such Account will at least equal the Loan Loss Requirement (with respect to refunding Bonds, after giving effect to the refunding); and

(iii) an amount to be transferred to and deposited into any Account or for any purpose not referred to in clauses (i) or (ii) above as provided in the applicable Series Resolution.

Transfers Outside Book-Entry System (Section 214)

In the event (i) the Securities Depository determines not to continue to act as Securities Depository for any Series of the Bonds, or (ii) the Department and the Trustee determine that the Securities Depository shall no longer so act and the Department delivers a written certificate to the Trustee to that effect, then the Department will discontinue the book-entry system with the Securities Depository with respect to such Series. If the Department and the Trustee determine to replace the Securities Depository with another qualified securities depository, the Department shall prepare or direct the preparation of a new, single, separate, fully registered bond for each of the maturities of the Bonds of such Series, registered in the name of such successor or substitute qualified securities depository or its nominee, or make such other arrangements acceptable to the Department and the Securities Depository as are not inconsistent with the terms of the Resolution or any Supplemental Resolution. If the Department and the Trustee fail to identify another qualified securities depository to replace the Securities Depository, then the Bonds of such Series shall no longer be restricted to being registered in the registration books of the Trustee in the name of the Nominee, but shall be registered in whatever name or names the Bondowner of Bonds transferring or exchanging Bonds shall designate in accordance with the Resolution. Notwithstanding anything in Section 214 of the Resolution to the contrary, the book-entry system may not be discontinued within the period commencing 15 days prior to the date of mailing a notice of redemption and ending on the redemption date specified in such notice.

Payments and Notices to the Nominee (Section 215)

Notwithstanding any other provision of the Resolution or any Supplemental Resolution to the contrary, so long as any Bond is registered in the name of the Nominee, all payments with respect to principal of, premium, if any, and interest on such Bond and all notices with respect to such Bond shall be made and given, respectively, as provided in the applicable Representation Letter or as otherwise instructed by the Securities Depository.

Effect of Calling for Redemption (Section 303)

On the date so designated for redemption if the conditions precedent, if any, to such redemption have been satisfied, any required notice which has not been waived having been given in the manner and under the conditions in the Resolution above provided, the Bonds or portions of Bonds so called for redemption shall become and be due and payable at the Redemption Price provided for redemption of such Bonds or portions of the Resolution on such date, and, if sufficient money or Government Obligations (the principal of and interest on which will provide sufficient money for payment of the Redemption Price and the accrued interest) are held by the Trustee in trust for the owners of the Bonds or portions thereof to be redeemed, as provided in the Resolution, such Bonds or portions thereof shall cease to be Outstanding under the provisions of the Resolution, interest on the Bonds or portions of Bonds so called for redemption shall cease to accrue, such Bonds or portions of Bonds shall cease to be entitled to any benefit or security under the Resolution and the owners of such Bonds or portions of Bonds shall have no rights in respect of the Resolution, except to receive payment of the Redemption Price of the Resolution and the accrued interest thereon to the date of redemption and, to the extent provided in Section 304 of the Resolution, to receive Bonds for any unredeemed portion of Bonds.

Establishment of Accounts (Section 401)

(a) The Resolution creates the following Accounts within the 1943 Fund:

Proceeds Account

Revenue Bond Series Proceeds Subaccounts

Revenue Bond Series Recycling Subaccounts

GO Bond Series Proceeds Subaccounts

GO Bond Series Recycling Subaccounts

Revenue Account

Revenue Bond Series Restricted Recoveries Subaccounts

Revenue Bond Series Revenue Subaccounts

GO Bond Series Restricted Recoveries Subaccounts

GO Bond Series Revenue Subaccounts

(b) The Resolution creates the following Accounts within the Veterans Debenture Fund and designated as set forth below:

Bond Reserve Account

Series Bond Reserve Subaccounts

Loan Loss Account

Series Loan Loss Subaccounts

Proceeds Account (Section 402)

(a) With respect to a Series of Bonds or a series of Veterans General Obligation Bonds, unless otherwise provided in the applicable Series Resolution or resolution of issuance governing such Veterans General Obligation Bonds, respectively, the Trustee shall establish a Series Proceeds Subaccount and a Series Recycling Subaccount within the Proceeds Account applicable to such Series of Bonds or series of Veterans General Obligation Bonds. The Trustee shall deposit amounts received in connection with the issuance of Bonds or Veterans General Obligation Bonds into the Proceeds Account or any such Subaccount in the amount(s) and at the time(s) set forth in the Series Resolution or resolution of issuance, respectively, authorizing the issuance of the Resolution. Amounts shall also be deposited in the Proceeds Account from a transfer of funds from the Revenue Account pursuant to the provisions of Section 403(c)(11) of the Resolution. Amounts on deposit in the Proceeds Account may be transferred between various Series Proceeds Subaccounts and Series Recycling Subaccounts, as set forth in the Program Operating Procedures.

(b) Moneys in the Proceeds Account shall be withdrawn or transferred therefrom in accordance with law upon requisition of the Department for the purpose of carrying out the provisions of the Bond Act and the Program Acts, including by entering into Contracts of Purchase, and by paying administrative expenses of the Department, including Costs of Issuance.

(c) The Trustee shall transfer from the Proceeds Account any amount specified by the Department from time to time in a Department Request for the purpose of redeeming or purchasing Bonds or for the purpose of funding the Bond Reserve Account as provided in the applicable Series Resolution and Program Operating Procedures.

(d) The Trustee shall transfer any amount deposited in a Series Recycling Subaccount to the related Series Restricted Recoveries Subaccount or to the related Series Revenue Subaccount, upon a Department Request in the amount and at the time(s) stated in such Department Request.

(e) Moneys held for the credit of the Proceeds Account shall be transferred to be applied for payment of Bonds or Veterans General Obligation Bonds pursuant to Section 410 of the Resolution.

Revenue Account; Application of Revenues (Section 403)

(a) The Department shall transfer all Revenues to the Trustee for deposit in the Revenue Account upon the Department's identification and receipt thereof. Upon transfer, the Department shall identify the amount of Restricted Recoveries included in such Revenues and deposit the same, unless otherwise provided in the applicable Series Resolution or any resolution of issuance governing a series of Veterans General Obligation Bonds, in the related Series Restricted Recoveries Subaccount. The balance shall be deposited in the related Series Revenue Subaccount.

(b) Pursuant to a Department Request, based on the Department's determination that certain Revenues previously deposited in a Series Revenue Subaccount constitute Restricted Recoveries, the Trustee shall transfer Revenues in an amount equal to and representing such Restricted Recoveries from the Series Revenue Subaccount to the related Series Restricted Recoveries Subaccount (if any).

(c) From time to time as required or as otherwise directed by Department Request, the Department shall cause to be transferred, applied, or retained all Revenues in the Revenue Account (not including Series Restricted Recoveries Subaccounts, which shall be governed by Section 409 of the Resolution) for the following purposes (subject, in the case of any deficiency in available Revenues to meet the requirements of one or more of clauses (1) through (6), to the provisions as to deficiency contained in Section 410):

(1) In accordance with the applicable Series Resolution to transfer to any Rebate Account, or otherwise to the U.S. Treasury, the amount(s) if any, specified by Department Request;

(2) From the GO Bond Series Revenue Subaccounts, to reimburse the General Fund for amounts previously paid out of the General Fund (and not previously reimbursed pursuant to this provision) for principal of and interest on the Veterans General Obligation Bonds of the related series (together with interest at the same rate as borne by said bonds, compounded semiannually, from the due date of such principal and interest to the date of such reimbursement);

(3) From the GO Bond Series Revenue Subaccounts, to transfer to the General Fund the amount of the principal of and interest then due on the Veterans General Obligation Bonds of the related series and the amount of Credit and Liquidity Support Expenses then due and related thereto;

(4) From the Revenue Bond Series Revenue Subaccounts, to pay interest due on the Bonds of the related Series;

(5) From the Revenue Bond Series Revenue Subaccounts, to pay principal (including by operation of Mandatory Sinking Account Payments) due on the Bonds of the related Series;

(6) From the Revenue Bond Series Revenue Subaccounts, to pay any Credit and Liquidity Support Expenses then due and related to the Bonds of the related Series;

(7) From the Revenue Bond Series Revenue Subaccounts, upon Department Request and (without Department Request) at least once every month, to deposit to the credit of the Bond Reserve Account an amount sufficient to cause the amount on deposit in said Account to equal the Bond Reserve Requirement (to be allocated among any Revenue Bond Series Bond Reserve Subaccounts in accordance with the Program Operating Procedures);

(8) From the Revenue Bond Series Revenue Subaccounts, pursuant to the terms of a Series Resolution upon the issuance of a Series of Bonds, to transfer such amount as is required to cause the amount in the Loan Loss Account to equal the Loan Loss Requirement;

(9) From all Series Revenue Subaccounts pursuant to Program Operating Procedures to transfer an amount to the Department for deposit to any operating or other account, free and clear of the lien of this Resolution, equal to Expenses specified in a Department Request as contemplated by the Program Operating Procedures;

(10) From the GO Bond Series Revenue Subaccounts, on the first day of each month, to accumulate in the GO Bond Series Revenue Subaccounts collectively (in such respective allocations made at such times as are required by the Program Operating Procedures), an amount equal to Accrued Debt Service on the Veterans General Obligation Bonds of all series;

(11) From any Series Revenue Subaccount, upon Department Request, to transfer amounts for credit to the related Series Recycling Subaccount; and

(12) With respect to amounts constituting Excess Revenues or Restricted Recoveries, to redeem any Series of Bonds or series of Veterans General Obligation Bonds upon Department Request and in accordance with the provisions of a Series Resolution or Supplemental Resolution, or resolution of issuance governing such Veterans General Obligation Bonds, respectively.

(d) Amounts on deposit in the Revenue Account upon Department Request may be transferred between any Series Restricted Recoveries Subaccount or Series Revenue Subaccount and any other Series Restricted Recoveries Subaccount or Series Revenue Subaccount, as set forth in the Program Operating Procedures.

Interest (Section 404)

In payment of interest on Bonds, the Trustee shall remit (or other method of transfer acceptable to the Department and to any Securities Depository) (i) by mail to each owner of Bonds the amounts required for paying the interest on such Bonds as such interest becomes due and payable and (ii) payment for any Credit and Liquidity Support Expenses relating to such Bonds as described in Section 403(c)(6) of the Resolution. An Authorized Representative of the Department shall advise the Trustee regarding the amount of any such Credit and Liquidity Support Expenses and when payment is due.

Principal (Section 405)

(a) *Principal Payments.* The Trustee shall set aside in the Revenue Account for remittance to Bondowners the amounts required for paying the principal of all Bonds as such principal becomes due and payable.

(b) *Mandatory Sinking Account Payments Redemption.* Amounts on deposit in any Revenue Bond Series Revenue Subaccount prior to being applied in satisfaction of Mandatory Sinking Account Payments shall be applied as applicable to the purchase of Term Bonds of the related Series then Outstanding subject to Mandatory Sinking Account Payments on the next date such

payments are scheduled as provided in the paragraph. The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase the Term Bonds or portions of Term Bonds of and related Series stated to mature on the next maturity date or to be redeemed pursuant to Mandatory Sinking Account Payments for Term Bonds of such Series then Outstanding at a price not to exceed the Redemption Price (plus accrued interest to the date of redemption) which would be payable on the next redemption date to the Owners of such Term Bonds under the provisions of the applicable Series Resolution if such Term Bonds or portions of Term Bonds should be called for redemption on such date. *Provided, however,* that, subject to applicable law, *notwithstanding* the maximum purchase price set forth in the preceding sentence, if at any time the investment earnings on the moneys in the Revenue Account equal to the Mandatory Sinking Account Payments for the next date such payments are scheduled shall be less than the interest accruing on the Bonds to be redeemed on such date from such Mandatory Sinking Account Payments, then the Trustee may pay a purchase price for any such Bond in excess of the Redemption Price which would be payable on the next redemption date to the owner of such Bond under the provisions of the applicable Series Resolution, if an Authorized Representative certifies to the Trustee that the amount paid in excess of said Redemption Price is expected to be less than the interest which is expected to accrue on said Bond less any investment earnings on such available moneys during the period from the settlement date of the proposed purchase to the redemption date. The Trustee shall pay the interest accrued on such Term Bonds or portions of Term Bonds to the date of settlement therefor from the Revenue Account. *Notwithstanding* the foregoing, no such purchase shall be made by the Trustee after the giving of notice of redemption by the Trustee.

(c) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of the Resolution. Upon retirement of any Term Bonds by purchase or redemption pursuant to the provisions of Section 405 of the Resolution, the Trustee shall file with the Department a statement identifying such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Redemption (Section 406)

(a) The Trustee shall apply all amounts in Revenue Bond Series Restricted Recoveries Subaccounts, and all moneys otherwise set aside in the Revenue Account for the redemption of Bonds pursuant to Section 403(c)(12) of the Resolution, to the purchase or redemption of Bonds issued under the provisions of the Resolution, as follows:

(1) The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase Bonds or portions of Bonds then Outstanding, whether or not such Bonds or portions of Bonds shall then be subject to redemption, at a price not to exceed the Redemption Price (plus accrued interest, if any, to the date of redemption) which would be payable on the next redemption date to the owners of such Bonds if such Bonds or portions of Bonds should be called for redemption on such date from the moneys in the respective Account. Such maximum purchase price may be exceeded in accordance with the proviso in Section 405(b) of the Resolution. The Trustee shall pay the interest accrued on such Bonds to the date of settlement therefor from the Revenue Account, but no such purchase shall be contracted for by the Trustee after the giving of notice by the Trustee that such Bonds have been called for redemption except from moneys other than the moneys set aside for the redemption of such Bonds.

(2) The Trustee, having endeavored to purchase Bonds pursuant to subsection (1) of the subsection (a), shall call for redemption, on the earliest practicable date on which Bonds

are subject to redemption from such moneys, such amount (computed on the basis of Redemption Prices) of Bonds as will exhaust the moneys set aside for such redemption, as nearly as may be practicable.

(b) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of the Resolution. Prior to calling Bonds or portions of Bonds for redemption, the Trustee shall set aside the respective amounts required for paying the interest on and the Redemption Price of the Bonds or portions of Bonds so called for redemption. Upon the retirement of any Bonds under the Section 406 of the Resolution by purchase or redemption, the Trustee shall file with the Department a statement briefly describing such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Bond Reserve Account (Section 407)

(a) Moneys held for the credit of the Bond Reserve Account shall be transferred by the Trustee to be applied for payment of Bonds pursuant to Section 410 of the Resolution.

(b) Moneys held for the credit of the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement upon Department Request shall be transferred to the Loan Loss Account, the Revenue Account or the Proceeds Account.

(c) A Series Resolution may provide that the Bond Reserve Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with any discussion in the Resolution of "moneys" on deposit in or held for the credit of the Bond Reserve Account, "moneys" shall be deemed to include said Cash Equivalents.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Bond Reserve Account to equal the Bond Reserve Requirement from available amounts in the 1943 Fund.

Loan Loss Account (Section 408)

(a) Pursuant to the Program Operating Procedures, moneys held for the credit of the Loan Loss Account as of any date upon Department Request shall be transferred to the Revenue Account, the Bond Reserve Account, the Proceeds Account or any GO Bond Series Revenue Subaccount.

(b) A Series Resolution may provide that the Loan Loss Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with any discussion in the Resolution of "moneys" on deposit in or held for the credit of the Loan Loss Account, "moneys" shall be deemed to include said Cash Equivalents.

(c) Moneys held for the credit of the Loan Loss Account shall be transferred by the Trustee to be applied for payment of Bonds, pursuant to Section 410 of the Resolution.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Loan Loss Account to equal the Loan Loss Requirement from available amounts in the 1943 Fund.

(e) To the extent set forth in a Department Request, the Trustee shall apply amounts in the Loan Loss Account to remedy shortfalls in recoveries on Contracts of Purchase financed by or otherwise allocable to the Veterans General Obligation Bonds of any series.

Restricted Recoveries (Section 409)

Upon the issuance of a Series of Bonds or series of Veterans General Obligation Bonds, if so required by the terms of the Series Resolution or resolution of issuance governing the Veterans

General Obligation Bonds, the Trustee shall establish a Series Restricted Recoveries Subaccount within the Revenue Account applicable to such Series of Bonds or series of Veterans General Obligation Bonds. If the Trustee does not receive a Department Request with respect to a mandatory redemption from Restricted Recoveries set forth in a Series Resolution, the Trustee shall apply Restricted Recoveries in an amount sufficient to accomplish such mandatory redemption to a redemption of Bonds (subject to any other priority set forth in the applicable Series Resolution) on a pro rata basis, as nearly as practicable, from among each maturity of the Series (and sub-series, if applicable) of Bonds which financed the related Contracts of Purchase. Upon Department Request, the Trustee shall transfer amounts in any Series Restricted Recoveries Subaccount to the related Series Revenue Subaccount.

Deficiencies in Debt Service (Section 410)

In the event that amounts in the Revenue Account shall be insufficient on any interest payment date or principal payment date for the Bonds or the Veterans General Obligation Bonds to pay the principal of and interest on such Bonds, or provide for payment with respect to Veterans General Obligation Bonds pursuant to the provisions of Section 403(c)(2) or (3) of the Resolution in each case if payment is due and unpaid on such date, whether at the stated payment or maturity date or by the retirement thereof by Mandatory Sinking Account Payments (or sinking account retirement with respect to the Veterans General Obligation Bonds) therefor, the Trustee shall withdraw amounts from the following Accounts in the following order of priority to the extent necessary to eliminate such deficiency; *provided, however*, that no amounts shall be used for such purpose to the extent that such amounts have been set aside for the payment of Bonds or Veterans General Obligation Bonds which have been identified for purchase pursuant to Section 403 or 406 of the Resolution or called for redemption, and no amounts on deposit in the Proceeds Account shall be used for such purpose to the extent that the Department is contractually obligated to enter into Contracts of Purchase acceptable for financing with such amounts:

(a) With respect to deficiencies in payments related to Veterans General Obligation Bonds, in the following order of priority:

- (i) GO Bond Series Recycling Subaccounts;
- (ii) GO Bond Series Proceeds Subaccounts;
- (iii) GO Bond Series Restricted Recoveries Subaccounts;
- (iv) Revenue Bond Series Revenue Subaccounts;
- (v) Revenue Bond Series Recycling Subaccounts;
- (vi) Revenue Bond Series Proceeds Subaccounts; and
- (vii) Revenue Bond Series Restricted Recoveries Subaccounts.

(b) With respect to deficiencies in debt service related to Bonds, in the following order of priority:

- (i) Revenue Bond Series Recycling Subaccounts;
- (ii) Revenue Bond Series Proceeds Subaccounts;
- (iii) Revenue Bond Series Restricted Recoveries Subaccounts;
- (iv) GO Bond Series Revenue Subaccounts;
- (v) GO Bond Series Recycling Subaccounts;
- (vi) GO Bond Series Proceeds Subaccounts;
- (vii) GO Bond Series Restricted Recoveries Subaccounts;

- (viii) Loan Loss Account; and
- (ix) Bond Reserve Account.

Moneys Held in Trust (Section 411)

(a) All moneys which the Trustee shall have withdrawn or set aside for the purpose of payment of any of the Bonds by the Resolution secured, either at the maturity thereof or upon call for redemption, shall be held in trust for the respective owners of such Bonds and such moneys shall not be subject to lien or attachment by any creditor of the Department or the Trustee. Any moneys which shall be so set aside by the Trustee and which shall remain unclaimed by the owners of such Bonds for the period of two (2) years after the date on which such Bonds or the interest thereon shall have become due and payable shall be paid to the Department or to such officer, board or body as may then be entitled by law to receive the same, and thereafter the owners of such Bonds shall look only to the Department or to such officer, board or body, as the case may be, for payment and then only to the extent of the amounts so received without any interest thereon, and the Trustee shall have no responsibility with respect to such moneys.

(b) If sufficient money or Government Obligations (the principal of or interest on which will provide sufficient money for payment of the principal amount or accrued interest on the Bonds on their maturity date or each date thereafter that they become due by redemption or otherwise) are held by the Trustee in trust for the Owners of Bonds, such Bonds shall cease to be Outstanding under the provisions of the Resolution, interest on the Bonds which have matured shall cease to accrue, such Bonds shall cease to be entitled to any benefit or security under the Resolution, and the owners of such Bonds shall have no rights in respect thereof, except to receive payment of the principal amount thereof and accrued interest thereon to the maturity date. Notwithstanding any provision of the Resolution to the contrary, the Department may issue refunding Bonds to refund the liabilities remaining on any such Bonds, despite their characterization for other purposes as not Outstanding hereunder.

Security for Deposits (Section 501)

All money deposited with a co-Trustee in any Account created under the Resolution shall, unless invested in Investment Obligations in accordance with Section 502 (except, to the extent applicable, the last paragraph of Section 502) of the Resolution, to the extent such deposits are in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other Federal agency, be continuously secured (if permitted by law), for the benefit of the Department and the owners of the Bonds either (a) by lodging with a bank or trust company selected by the Department as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit as collateral security, Government Obligations or, with the approval of the Department, other marketable securities eligible as security for the deposit of trust funds under regulations of the Comptroller of the Currency of the United States of America, having a market value at all times (exclusive of accrued interest) not less than the amount of such deposit, or (b) if the furnishing of security as provided in clause (a) of Section 501 of the Resolution is not permitted by applicable law, then in such other manner as may then be required or permitted by applicable State or Federal laws and regulations regarding the security for, or granting a preference in the case of, the deposit of trust funds; *provided, however*, that it shall not be necessary, except as otherwise expressly provided, for the Trustee to give security for any money which shall be represented by obligations purchased under the provisions of Article I of the Resolution as an investment of such money.

Investment of Moneys (Section 502)

The Revenue Bond Series Proceeds Subaccounts, Series Recycling Subaccounts, Series Restricted Recoveries Subaccounts, Series Revenue Subaccounts, Loan Loss Account and Bond Reserve Account shall, as nearly as is practicable, be fully and continuously invested or reinvested in Investment Obligations.

Covenant Against Encumbrances (Section 605)

The Department covenants that, except as expressly permitted in the Resolution, it will not sell, convey, mortgage, encumber or otherwise dispose of the money held for the credit of any Fund or Account created under the Resolution *except* the pledge created by the Resolution and any interest or right to which such pledge is by its terms secondary and subordinate or take any other action which would adversely affect the security of the Bondowners stated in the Resolution.

Program Operating Procedures (Section 606)

(a) The Department shall have on file with the Trustee at all times during which Bonds are Outstanding current Program Operating Procedures accompanied by a Counsel's Opinion that the same are consistent with the provisions of the Resolution.

(b) Upon adoption of Program Operating Procedures, the Department shall thereafter administer the Program and perform its obligations under the Resolution in accordance in all material respects with the Program Operating Procedures. Any action taken by the Department with respect to Contracts of Purchase, Bonds and Pledged Property shall be deemed a representation and warranty by the Department under the Resolution that such action is in conformance with any provision of the current Program Operating Procedures applicable thereto.

(c) The Program Operating Procedures may be amended only if (1) a Cash Flow Statement is delivered to the Trustee, and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on the Bonds from the gross income of the holders of the Resolution for federal income tax purposes.

Cash Flow Statements (Section 607)

(a) The Department shall file with the Trustee a current Cash Flow Statement (i) upon adoption of each Series Resolution and each Supplemental Resolution; (ii) upon issuance of any series of Veterans General Obligation Bonds; (iii) when required pursuant to any Series Resolution or Supplemental Resolution; (iv) upon any change in the Program Operating Procedures; and (v) whenever required pursuant to the provisions of Section 608 of the Resolution. The Department may file a new or amended Cash Flow Statement conforming to the requirements of Section 608 of the Resolution at any time. Any Cash Flow Statement shall be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

(b) A Cash Flow Statement shall consist of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto. The Cash Flow Statement shall include each scenario included in the immediately prior Cash Flow Statement except as may be required by any Rating Agency in connection with a Rating Confirmation. A Cash Flow Statement shall (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account and the Loan Loss Account as of the stated starting date of the projection, (ii) reflect all the significant transactions that have occurred in the period commencing with such

starting date and ending with a date no more than ninety (90) days prior to the date of such projections, (iii) be consistent with the Resolution and (iv) assume compliance with the Program Operating Procedures.

(c) The Cash Flow Statement shall set forth for each scenario included therein the sets of assumptions on which it is based including, without limitation, the following:

(i) the timing and terms of issuance or remarketing of Bonds and Veterans General Obligation Bonds;

(ii) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;

(iii) the timing and amounts of the receipt of payments of scheduled principal or and interest on Contracts of Purchase;

(iv) the timing and amounts of prepayments on Contracts of Purchase;

(v) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;

(vi) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will not be subject to an investment agreement;

(vii) the performance by the Department's counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds.

(viii) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and

(ix) the Loan Loss Requirement.

(d) If any Cash Flow Statement shall show that projected Revenues shall be insufficient to provide for timely payments of interest on and principal of the Bonds and Expenses, the Department shall not be in default under the Resolution but shall take all reasonable actions to eliminate such deficiency. The Department shall be precluded from taking the actions described or referenced in clauses (i) through (iv) of subsection (a) of Section 607 of the Resolution if the Cash Flow Statement on file with the Trustee in accordance with the requirements of the first paragraph of the Resolution shall show that the taking of such action shall cause a deficiency to occur or shall increase any existing deficiency.

Maintenance of Fund Parity (Section 608)

The Department shall cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals the Applicable Fund Parity Percentage (provided that any Applicable Fund Parity Percentage which is less than 50% shall be the subject of a Rating Confirmation) of the then Outstanding aggregate principal amount of Bonds, all Excess Revenues shall thereafter be applied to redeem Bonds of the Series and in the manner reflected in the current Cash Flow Statement until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such 50% (or such other percentage) level; provided, however, that no such Cash Flow Statement and no such redemption shall be required under the Resolution if the Department shall have provided a Rating Confirmation to the Trustee.

Tax Covenants (Section 609)

The Department shall at all times perform the applicable tax covenants contained in any applicable Series Resolution. In addition, the Department shall not amend the interest rates on any existing Contracts of Purchase unless the Department shall have provided the Trustee with an opinion of nationally recognized bond counsel to the effect that such action will not impair any exclusion of interest on the Bonds issued with the intent that such interest be excluded from gross income for federal income tax purposes.

Books and Records (Section 611)

(a) The Trustee shall keep proper books of record and account in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocations and applications of all moneys received by the Trustee hereunder, and such books shall be available for inspection by the Department and any Bondowner during business hours, upon reasonable notice and under reasonable conditions.

(b) The Department shall keep proper books of records and account for all its transactions, other than those recorded in the books maintained by the Trustee pursuant to subsection (a) of Section 611 of the Resolution, and such books shall be available for inspection by the Trustee and any Bondowner during business hours and upon reasonable notice.

Annual Audit, Report and No-Default Certificate (Section 612)

By the first day of the tenth month after the end of each Fiscal Year, the Department shall furnish to the Trustee (i) a statement of the revenues and expenses and of the changes in the fund balances during the previous Fiscal Year, in each case with respect to the 1943 Fund, the Bond Reserve Account and the Loan Loss Account, certified to by an Accountant, and (ii) a certificate from an Authorized Representative stating that there is no current Event of Default and that no Event of Default occurred during the preceding Fiscal Year (or if there has been an Event of Default, providing the details of the Resolution and describing the steps the Department took, or is taking, to cure such Event of Default).

Program Covenants (Section 614)

The Department shall from time to time, with all practical dispatch and in a sound and economical manner consistent in all respects with the Bond Act, the Program Acts, the Resolution and all other applicable laws and regulations and with sound banking practices and principles, use and apply the amounts held in the 1943 Fund and available therefor to the financing of Contracts of Purchase and to other uses permitted under the Resolution and the law, and shall take all steps, actions and proceedings reasonable and necessary in the judgment of the Department to enforce the terms, covenants and conditions of each Contract of Purchase.

Issuance of Additional Obligations and Subordinate Obligations (Section 615)

The Department, so long as any Bonds shall be Outstanding hereunder, shall not issue any bonds, notes or other evidences of indebtedness, other than the Bonds, secured by any pledge of or other lien or charge on the Pledged Property nor shall the Department create or cause to be created any lien or charge on the Pledged Property, other than the lien and pledge created under the Resolution and other than the rights of the State or the holders of the Veterans General Obligation Bonds. Nothing contained in the Section shall prevent the Department from issuing any bonds, notes or other evidences of indebtedness which are payable from or secured by a lien and pledge on the Pledged Property provided that payment of such evidences of indebtedness and such lien and pledge shall be in all respects subordinate to the provisions of the Resolution and the lien and pledge created by the Resolution and any such evidences of indebtedness shall contain an appropriate recital with respect to such subordination.

Events of Default Defined (Section 702)

Each of the following events is by the Resolution declared an "Event of Default", that is to say: If

(a) payment of the principal or Redemption Price of any of the Bonds shall not be made when the same shall become due and payable, either at maturity or by proceedings for redemption or otherwise; or

(b) payment of any installment of interest on any of the Bonds shall not be made when the same shall become due and payable; or

(c) the entry of a decree or order for relief by a court having jurisdiction in the premises in respect of the Department in an involuntary case under the Federal bankruptcy laws, as now or hereafter constituted, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator (or similar official) of the Department or for any substantial part of its property, or ordering the winding-up or liquidation of its affairs and the continuance of any such decree or order unstayed and in effect for the period of 60 consecutive days; or

(d) the commencement by the Department of a voluntary case under the Federal bankruptcy laws, as now constituted or hereafter amended, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or the consent by it to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or other similar official) of the Department or for any substantial part of its property, or the making by it of any assignment for the benefit of creditors, or the taking of action by the Department in furtherance of any of the foregoing; or

(e) failure by the Department to pay, when due or within any applicable grace period, any amount owing on account of indebtedness for money borrowed or for deferred purchases of property, or the failure by the Department to observe or perform any covenant or undertaking on its part to be observed or performed in any agreement evidencing, securing or relating to such indebtedness, resulting, in any such case, in an event of default or acceleration by the holder of such indebtedness of the date on which such indebtedness would otherwise be due and payable; or

(f) the Department defaults in the due and punctual performance of any other covenants or agreements contained in the Bonds or in the Resolution and such default continues for 90 days after written notice requiring the same to be remedied shall have been given to the Department by the Trustee, which may give such notice in its discretion and shall give such notice at the written request of the owners of not less than twenty per centum (20%) in aggregate principal amount of Bonds then Outstanding; *provided, however*, that so long as following such notice the Department is diligently taking actions to remedy such default, such default shall not be an Event of Default.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Enforcement of Remedies (Section 704)

Upon the happening and continuance of any Event of Default specified in Section 702 of the Resolution, then and in every such case the Trustee may, and upon the written direction of the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then

Outstanding under the Resolution shall, proceed, subject to the provisions of Section 802 of the Resolution, to protect and enforce its rights and the rights of the Bondowners under applicable laws or under the Resolution by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, either for the specific performance of any covenant or agreement contained in the Resolution or in aid or execution of any power in the Resolution granted or for the enforcement of any proper legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce such rights.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Pro Rata Application of Funds (Section 706)

Anything in the Resolution to the contrary notwithstanding, if at any time the money in the Accounts maintained under the Resolution (other than any Rebate Account) shall not be sufficient to pay the principal of or interest on the Bonds as the same shall become due and payable such money, together with all amounts then on deposit in the 1943 Fund other than Veterans General Obligation Bonds proceeds, together with any money then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in the Article or otherwise, shall be applied, following the satisfaction of any payments due to the Trustee under the provisions of Section 802 and 805 of the Resolution, as follows:

(a) Except in the case of amounts on deposit in the Bond Reserve Account and the Loan Loss Account and interest, profit or other income derived from the investment of such amounts, for transfer to the General Fund in the State Treasury in accordance with and at the times stated in Sections 403(c)(2) and (3) of the Resolution.

(b) After application pursuant to clause (a) above, all such money shall be applied:

first: to the payment to the persons entitled thereto of all installments of interest on Bonds (*except* interest on overdue principal) then accrued and unpaid in the chronological order in which such installments of interest accrued and, if the amount available shall not be sufficient to pay in full any particular daily installment, then to the payment, ratably, according to the amounts due on such daily installment, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

second: to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (*except* Bonds called for redemption for the payment of which, money is held pursuant to the provisions of the Resolution) in the order of their stated payment dates, with interest on the principal amount of such Bonds at the respective rates specified therein from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of the Bonds by their stated terms due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, with such payment being made to owners of Bonds, and then to the payment of such principal, ratably, according to the amount of such

principal due on such date, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

third: to the payment of the interest on and the principal of the Bonds, to the purchase and retirement of Bonds and to the redemption of the Bonds, all in accordance with the provisions of Article III of the Resolution.

The provisions of subsection (a) of Section 706 of the Resolution are in all respects subject to the provisions of Section 701 of the Resolution.

(c) Whenever money is to be applied by the Trustee pursuant to the provisions of Section 706 of the Resolution, such money shall be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such money available for application and the likelihood of additional money becoming available for such application in the future; the deposit of such money with any paying agent, or otherwise setting aside such money, in trust for the proper purpose shall constitute proper application by the Trustee; and the Trustee shall incur no liability whatsoever to the Department, to any Bondowner or to any other person for any delay in applying any such money, so long as the Trustee acts with reasonable diligence, having due regard to the circumstances, and ultimately applies the same in accordance with such provisions of the Resolution as may be applicable at the time of application by the Trustee. Whenever the Trustee shall exercise such discretion in applying such money, it shall fix the date (which shall be an interest payment date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate of the fixing of any such date, and shall not be required to make payment to the owner of any Bond until such Bond shall be surrendered to the Trustee for appropriate endorsement, or for cancellation if fully paid.

Owners of Majority in Principal Amount of Bonds May Control Proceedings (Section 708)

Anything in the Resolution to the contrary notwithstanding, the owners of a majority in principal amount of the Bonds then Outstanding under the Resolution shall have the right, subject to the provisions of Section 802 of the Resolution, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Resolution or exercising any trust or power conferred upon the Trustee, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Resolution, and the Act and, in the sole judgment of the Trustee, is not unduly prejudicial to the interests of Bondowners not joining in such direction and *provided, further*, that nothing in Section 708 of the Resolution shall impair the right of the Trustee in its discretion to take any other action under the Resolution which it may deem proper and which is not inconsistent with such direction by Bondowners.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Restrictions Upon Actions by Individual Bondowner (Section 709)

No owner of any of the Bonds shall have any right to institute any suit, action or proceeding in equity or at law on any Bond or for the execution of any trust under the Resolution or for the

enforcement of any remedy under the Resolution *unless* such owner previously shall have given to the Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted, and *unless* also the owners of not less than fifteen per centum (15%) in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers in the Resolution above granted or to institute such action, suit or proceeding in its or their name, and unless, also, there shall have been offered to the Trustee reasonable security and indemnity against the costs, expenses and liabilities to be incurred therein or by the Resolution, and the Trustee shall have refused or neglected to comply with such request within a reasonable time; and such notification, request and offer of indemnity are by the Resolution declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers and trusts of the Resolution or to any other remedy hereunder; *provided, however*, that *notwithstanding* the foregoing provisions of Section 709 of the Resolution and without complying therewith, the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding may institute any such suit, action or proceeding in their own names for the benefit of all owners of Bonds hereunder. It is understood and intended that, *except* as otherwise above provided, no one or more owners of the Bonds by the Resolution secured shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Resolution, or to enforce any right under the Resolution except in the manner in the Resolution provided, that all suits, actions and proceedings at law or in equity shall be instituted, had and maintained in the manner in the Resolution provided and for the benefit of all owners of such Outstanding Bonds, and that any individual right of action or other right given to one or more of such owners by law is restricted by the Resolution to the rights and remedies in the Resolution provided.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Waiver of Defaults (Section 713)

The Trustee may, and upon written direction of the owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall, waive any default which in their opinion shall have been remedied before the entry of final judgment or decree in any suit, action or proceeding instituted by them under the provisions of the Resolution or before the completion of the enforcement of any other remedy under the Resolution, but no such waiver shall extend to or affect any other existing or any subsequent default or defaults or impair any rights or remedies consequent thereon.

Notice of an Event of Default (Section 714)

The Trustee shall mail to the Department and to all Bondowners, written notice of the occurrence of any Event of Default set forth in Section 702 of the Article within thirty (30) days after the Trustee shall have received written notice thereof from the Department, subject to the provisions of Section 708 of the Resolution, that any such Event of Default shall have occurred. The Trustee shall not, *however*, be subject to any liability to any Bondowner by reason of a failure to mail any such notice.

Acceptance of Trusts (Section 801)

(a) The Treasurer of the State shall act as trustee for the Department and the owners of the Bonds to receive and disburse all Revenues and other moneys applicable to the payment of the principal of or interest on the Bonds, including moneys in the 1943 Fund and the Veterans Debenture Fund, and otherwise to hold all the offices and to perform all the functions and duties provided in the Resolution to be held and performed by the Trustee, including acting as Bond Registrar pursuant to Section 208 of the Resolution. For purposes of Article VIII of the Resolution only, the term "Trustee" does not include any co-Trustee appointed pursuant to Section 801 of the Resolution.

(b) Upon the occurrence and continuance of an Event of Default, the Department shall, upon the request of the Trustee or of the owners of twenty percent (20%) in aggregate principal amount of the Bonds at the time outstanding, appoint a co-Trustee to represent and enforce the rights of the owners of the Bonds during the continuance of such or any other concurrent Event of Default.

(c) The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Resolution. The Trustee and the co-Trustee shall, during the continuance of any Event of Default (which has not been cured), exercise such of the rights and powers vested in the Trustee and co-Trustee by the Resolution, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

(d) The Department may at any time or from time to time appoint one or more Paying Agents, in addition to the Trustee and the co-Trustee, for the purpose of paying the principal or Redemption Price of and the interest on the Bonds of any Series. Each Paying Agent shall signify its acceptance of the duties and obligations imposed on it by the Resolution by executing and delivering to the Department and to the Trustee a written acceptance of the Resolution. The Department may remove any Paying Agent at any time by giving written notice of such removal to such Paying Agent and to the Trustee. Any Paying Agent may at any time resign by giving notice of such resignation to the Department. In the event of the resignation or removal of any Paying Agent, such Paying Agent shall pay over, transfer, assign and deliver any moneys held by it to its successor or, if there be no successor then appointed, to the Trustee. The Department shall give prompt notice to Bondowners of the acceptance of appointment by any successor Paying Agent.

Trustee or Co-Trustee Entitled to Indemnity (Section 802)

The Trustee or co-Trustee shall be under no obligation to institute any suit, or to take any remedial proceeding under the Resolution, or to enter any appearance or in any way defend in any suit in which it may be named as a defendant, or to take any steps in the execution of the trusts by the Resolution created or in the enforcement of any rights and powers hereunder, until it shall be indemnified to its satisfaction against any and all costs and expenses, outlays and counsel fees and other reasonable disbursements, and against all liability; the Trustee or co-Trustee may, nevertheless, begin suit, or appear in and defend suit, or do anything else in its judgment proper to be done by it as such Trustee or co-Trustee, without indemnity, and in such case the Department shall reimburse the Trustee or co-Trustee for all costs and expenses, outlays and counsel fees and other reasonable disbursements properly incurred in connection therewith.

Compensation and Indemnification of Trustee and Co-Trustee (Section 805)

The Department shall pay, from the Pledged Property, to the Trustee and co-Trustee reasonable compensation for all services performed by it under the Resolution and also all its reasonable expenses, charges and other disbursements and those of its attorneys, agents and employees

incurred in and about the administration and execution of the trusts by the Resolution created and the performance of its powers and duties hereunder, and from such source only, shall indemnify and save the Trustee and co-Trustee harmless against any liabilities which it may incur in the exercise and performance of its powers and duties under the Resolution.

Notice of Default (Section 807)

Except upon the happening of any Event of Default specified in clauses (a) and (b) of Section 702 of the Resolution, the Trustee or co-Trustee shall not be obliged to take notice or be deemed to have notice of any Event of Default, *unless* specifically notified in writing of such Event of Default by the Department or by the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds by the Resolution secured and then Outstanding.

Trustee or Co-Trustee Protected in Relying on Certain Documents (Section 810)

The Trustee and co-Trustee shall be protected and shall incur no liabilities in acting or proceeding, or in not acting or not proceeding, in good faith, reasonably and in accordance with the terms of the Resolution, upon any resolution, order, notice, request, consent, waiver, certificate, statement, affidavit, requisition, bond or other paper or document which it shall in good faith reasonably believe to be genuine and to have been adopted or signed by the proper board or person to have been prepared and furnished pursuant to any of the provisions of the Resolution, or upon the written opinion of any attorney, engineer or accountant believed by the Trustee or co-Trustee to be qualified in relation to the subject matter, and the Trustee or co-Trustee shall be under no duty to make any investigation or inquiry as to any statement contained or matters referred to in such instrument. The Trustee or co-Trustee shall not be under any obligation to see to the recording or filing of the Resolution.

Resignation and Removal of Co-Trustee Subject to Appointment of Successor (Section 811)

No resignation or removal of the co-Trustee and no appointment of a successor co-Trustee pursuant to Article VIII of the Resolution shall become effective until the acceptance of appointment by the successor co-Trustee under Section 814 of the Resolution.

Resignation of Co-Trustee (Section 812)

Subject to Section 811 of the Resolution, the co-Trustee may resign and by the Resolution become discharged from the trusts by the Resolution created, by notice in writing to be given to the Department and mailed, first class postage-prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Trustee, not less than sixty (60) days before such resignation is to take effect, but such resignation shall take effect immediately upon the appointment of a new co-Trustee hereunder, if such new Trustee or co-Trustee shall be appointed before the time limited by such notice and shall then accept the trusts of the Resolution.

Removal of Co-Trustee (Section 813)

Subject to Section 811 of the Resolution, the co-Trustee may be removed at any time by an instrument or concurrent instruments in writing executed by the Department without the consent of Bondowners or by the owners of not less than a majority in principal amount of the Bonds by the Resolution secured and then Outstanding and filed with the Department. A facsimile copy of each such instrument shall be delivered promptly by the Department to the co-Trustee. The co-Trustee may also be removed at any time for reasonable cause by any court of competent jurisdiction upon the application of the owners of not less than ten per centum (10%) in aggregate principal amount of the Bonds then Outstanding under the Resolution.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Appointment of Successor Co-Trustee (Section 814)

(a) If at any time hereafter the co-Trustee shall resign, be removed, be dissolved or otherwise become incapable of acting, or the bank or trust company acting as co-Trustee shall be taken over by any governmental official, agency, department or board, the position of co-Trustee shall thereupon become vacant. If the position of co-Trustee shall become vacant for any of the foregoing reasons or for any other reason, the Department shall cause notice of such appointment to be mailed, first class postage-prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Bond Registrar(s).

(b) At any time within one year after any such vacancy shall have occurred, the owners of a majority in principal amount of the Bonds then Outstanding, by an instrument or concurrent instruments in writing, executed by such Bondowners and filed with the Department, may appoint a successor co-Trustee, which shall supersede any co-Trustee theretofore appointed by the Department. Facsimile copies of each such instrument shall be delivered promptly by the Department to the predecessor co-Trustee and to the co-Trustee so appointed by the Bondowners.

(c) If no appointment of a successor co-Trustee shall be made pursuant to the foregoing provisions of the Section within ten (10) days after the vacancy shall have occurred, the owner of any Bond Outstanding under the Resolution or any retiring co-Trustee may apply to any court of competent jurisdiction to appoint a successor co-Trustee. Such court may thereupon, after such notice, if any, as such court may deem proper and prescribed, appoint a successor co-Trustee.

(d) Any co-Trustee hereafter appointed shall be a bank or trust company duly qualified to do business in the State, duly authorized to exercise corporate trust powers and subject to examination by Federal or State authority, of good standing, and having at the time of its appointment a combined capital and surplus aggregating not less than Fifty Million Dollars (\$50,000,000) as shown on its most recently published report of its financial condition.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

No Implied Duty; Standard of Care (Section 816)

The Trustee or co-Trustee shall have no duty or obligation *except* as expressly provided in the Resolution and no implied duties or obligations shall be read into the Resolution against the Trustee or co-Trustee. The Trustee or co-Trustee shall not incur any liability for any act or omission in performing its duties hereunder, *except* in the case of its own negligence or willful misconduct.

Bondowners' Consent Not Required (Section 1001)

The Department may, from time to time and at any time, adopt such resolutions supplemental to the Resolution which are filed with the Trustee (which Supplemental Resolutions shall thereafter form a part of the Resolution):

(a) to cure any ambiguity or defect or omission in the Resolution; or

(b) to grant to or confer upon the Trustee for the benefit of the Bondowners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondowners or the Trustee; or

(c) to include as pledged revenues or money under, and subject to the provisions of, the Resolution any additional revenues or money legally available therefor; or

(d) to make any other provisions with respect to matters or questions arising under the Resolution which shall not be inconsistent with the provisions of the Resolution, provided such action shall not materially adversely affect the interests of the Bondowners; or

(e) to add to the covenants and agreements of the Department in the Resolution other covenants and agreements thereafter to be observed by the Department or to surrender any right or power in the Resolution reserved to or conferred upon the Department; or

(f) to add provisions relating to Bonds with coupons appertaining thereto or Bonds issued with full book-entry delivery, if necessary, if the Department shall determine to so issue Bonds in such form under the Resolution; or

(g) to modify any of the provisions of the Resolution in any respect whatever not otherwise set forth in the Section 1001; *provided, however*, that either (i) such modification shall apply only to Series of Bonds issued after the effective date of the Supplemental Resolution and shall not materially adversely affect the interests of the owners of Bonds of any Series Outstanding on the effective date of the Supplemental Resolution or (ii) (a) such modification shall be, and be expressed to be, effective only after all Bonds of any Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding, and (b) such Supplemental Resolution shall be specifically referred to in the text of all Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Bonds issued in exchange therefor or in place of the Resolution; or

(h) to modify, amend or supplement the Resolution or any Supplemental Resolution in such manner as to permit, if presented, the qualification of the Resolution and of the Supplemental Resolution under the Trust Indenture Act of 1939 or any similar Federal statute hereafter in effect or under any state Blue Sky Law; or

(i) to surrender any right, power or privilege reserved to or conferred upon the Department by the terms of the Resolution, provided that the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of the Department contained in the Resolution; or

(j) if the subject of a Rating Confirmation and if approved by the Trustee, to add to the definition of Investment Obligations pursuant to the last proviso of the definition thereof; or

(k) [reserved]

(l) accompanied by a Rating Confirmation, to make any amendment or supplement necessary to accommodate credit enhancement or liquidity support for any or all Series of Bonds; or

(m) to increase the amount of the combined Bond Reserve Requirement and Loan Loss Requirement to an amount greater than ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding Bonds; or

(n) to amend and supplement provisions of the Resolution regarding the Trustee, and the rights of the Department and the owners of Bonds with respect to appointment and replacement of the Trustee, in the event and to the extent the laws of the State are amended to allow

an institution other than the State Treasurer to act as Trustee, provided, that any such institution shall meet the qualifications set forth in Section 814(d) of the Resolution as if such institution were acting as co-Trustee under the Resolution; or

(o) to make any other change which, in the judgment of the Trustee, does not materially adversely affect the interests of the Bondowners.

Supplements and Amendments Requiring Consent of Owners of a Majority in Principal Amount of Bonds (Section 1002)

Subject to the terms and provisions contained in Section 1002, and not otherwise, (i) the owners of not less than fifty-one per centum (51%) in aggregate principal amount of the Bonds then Outstanding; and (ii) if less than all of the Bonds then Outstanding are affected, the owners of not less than fifty-one per centum (51%) in principal amount of Bonds so affected then Outstanding, shall have the right, from time to time, anything contained in the Resolution to the contrary *notwithstanding*, to consent to and approve the adoption by the Department and the Trustee of such resolution or resolutions supplemental to the Resolution as shall be deemed necessary or desirable by the Department for the purpose of modifying, altering, amending, adding to, repealing or rescinding, in any particular, any of the terms or provisions contained in the Resolution or in any Supplemental Resolution. Notwithstanding the foregoing, nothing in the Resolution contained shall permit, or be construed as permitting, without the consent of all materially adversely affected Bondowners, (a) any change in the terms of redemption or of the maturity of the principal of or the interest on any Bond issued hereunder, or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of the Pledged Property, or any part thereof, other than the lien and pledge created or permitted by the Resolution, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, except as may be permitted by the applicable Series Resolution(s), or (e) a reduction in the aggregate principal amount or classes of the Bonds required for consent to such Supplemental Resolution, or (f) an amendment or modification of the rights or obligations of the Trustee without the written consent of the Trustee. Nothing in the Resolution contained, *however*, shall be construed as making necessary the approval by Bondowners of the execution of any Supplemental Resolution as authorized in Section 1001 of the Resolution. If any such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under Section 1002 of the Resolution. For the purpose of Section 1002 of the Resolution, a Series shall be deemed to be affected by a modification or amendment of the Resolution or a Supplemental Resolution if the same adversely affects or diminishes the rights of the owner of Bonds of such Series. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment, Bonds of any particular Series and maturity would be affected by any modification or amendment of the Resolution or a Supplemental Resolution and any such determination shall be binding and conclusive on the Department and all owners of Bonds.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds) Outstanding under the Resolution, the Insurer, as the provider of the 1998 Series A Municipal Bond Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds which it insures. See "The Insurer Treated as Bondowner for Certain Actions."

Defeasance (Section 1101)

If, when the Bonds secured by the Resolution shall have become due and payable in accordance with their terms or otherwise as provided in the Resolution, or shall have been duly called

for redemption or irrevocable instructions to call the Bonds for redemption shall have been given by the Department to the Trustee and (a) the whole amount of the principal of, Redemption Price, and the interest on all of such Bonds shall be paid, or (b) the Trustee shall hold money or Government Obligations or shall hold money and Government Obligations, sufficient to pay the principal of, Redemption Price, and interest on all Outstanding Bonds on their respective interest payment, stated maturity or prescribed redemption dates, provided that such Government Obligations shall be in such amount that the principal of and the interest on such Government Obligations so held by the Trustee, when due and payable, will provide sufficient money which, with any and all other money held by the Trustee for such purpose under the provisions of the Resolution, shall be sufficient to pay such principal of, Redemption Price, and the interest on such Bonds and, if sufficient funds shall also have been provided for paying all other obligations payable under the Resolution by the Department, then and in that case the right, title and interest of the Trustee under the Resolution shall thereupon cease, terminate and become void, and the Trustee in such case, on demand of the Department, shall release the Resolution and shall release the security, and shall execute such documents to evidence such release as may be reasonably required by the Department, and shall turn over to the Department or to such officer, board, or body as may then be entitled to receive the same, all the remaining property held by the Trustee under the Resolution. Otherwise, the Resolution shall be, continue and remain in full force and effect; *provided, however*, that in the event money or Government Obligations shall be deposited with and held by the Trustee as in the Resolution above provided, applicable provisions of the Resolution, particularly Articles II, III, VII and XI, pertaining to the payment of the principal and Redemption Price of, or interest on the Bonds issued under the Resolution and other obligations payable under the Resolution by the Department, shall be continued in force until such Bonds and other obligations have been fully paid.

The Insurer Treated as Bondowner for Certain Actions

The Ninth Supplemental Resolution provides that with respect to the 1998 Series A Bonds, during such time as: (i) the Insurer is not in default under the terms and conditions of the 1998 Series A Municipal Bond Insurance Policy; and (ii) the 1998 Series A Municipal Bond Insurance Policy is in full force and effect, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, (a) at all times for the purpose of the adoption of a Supplemental Resolution amending, changing or modifying the Resolution, or the initiation by Bondowners of any action to be undertaken by the Trustee at the Bondowner's request, or the removal of the co-Trustee, which under the Resolution requires the written approval or consent of the owners of all or a portion of the 1998 Series A Bonds at the time Outstanding under the Resolution or that can be initiated upon the written request of the owners of not less than all or a portion of the Bonds Outstanding under the Resolution, and (b) following an Event of Default for all other purposes.

The Ninth Supplemental Resolution further provides that the Insurer will, to the extent it makes payment of principal of or interest on a 1998 Series A Bond pursuant to the 1998 Series A Municipal Bond Insurance Policy, and obtains an assignment of the 1998 Series A Bondowner's rights in, to and under the 1998 Series A Bond, as provided in the 1998 Series A Municipal Bond Insurance Policy with respect to the 1998 Series A Bonds, be subrogated to the rights of such Bondowner.

TAX MATTERS

Federal Tax Matters

The Offered Revenue Bonds and the 1997 Veterans G.O. Bonds are being issued as a single issue for certain federal tax law purposes. The requirements of applicable federal tax law must be

satisfied with respect to the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds in order that interest on the Offered Revenue Bonds not be included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Tax Code

The Tax Code contains the following loan eligibility requirements, all of which are applicable to new Contracts of Purchase (or portions of new Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to the Offered Revenue Bonds (the "New 1997/1998 Revenue Bonds Contracts of Purchase"), and certain of which are applicable to the Allocated Prior Revenue Bonds Contracts of Purchase (such Allocated Prior Revenue Bonds Contracts of Purchase, collectively, the "Existing Contracts") (*except* that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code—Recapture Provision" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes). These requirements must be satisfied for New 1997/1998 Revenue Bonds Contracts of Purchase, and must have been satisfied at the time of origination for Existing Contracts, in order that interest on the Offered Revenue Bonds not be included in gross income for federal income tax purposes retroactive to their date of issuance. The requirements described below are not applicable to certain of the Prior Revenue Bonds Contracts of Purchase (other than the Allocated Prior Revenue Bonds Contracts of Purchase).

Generally, only the requirements described below under the headings "Residence Requirement," "New Mortgage Requirement" and "Qualified Home Improvement Loans" (except the \$15,000 maximum loan amount) apply to any Contracts of Purchase financed with Veterans G.O. Bonds.

Residence Requirement. The Tax Code requires that each of the premises financed with proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with New 1997/1998 Revenue Bonds Contracts of Purchase and Existing Contracts which finance the acquisition of single family homes in order to assure that interest paid on the Offered Revenue Bonds not be included in gross income for federal income tax purposes under the Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with New 1997/1998 Revenue Bonds Contracts of Purchase and Existing Contracts to finance home improvement loans in order to assure that interest paid on the Offered Revenue Bonds is not included in gross income for federal income tax purposes under the Tax Code (the "Home Improvement Program Documents"; together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of an Existing Contract or a New 1997/1998 Revenue Bonds Contract of Purchase, the Program Documents require or required that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Existing Contract or New 1997/1998 Revenue Bonds Contract of Purchase.

First-Time Homebuyer Requirement. The Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. This limitation, *however*, does not apply to the mortgagor's interest in the residence being financed or to certain residences in certain Presidentially-declared disaster areas; and all financing with respect to targeted area residences

and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. The Department verifies compliance with the first-time homebuyer requirement by having veterans subject to this requirement so certify when applying for an Existing Contract or a New 1997/1998 Revenue Bonds Contract of Purchase, and the Program Documents require or required that a reasonable investigation be made to verify such certification. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Department verifies compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas or residences in certain Presidentially-declared disaster areas. The Department verifies compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (with respect to New 1997/1998 Revenue Bonds Contracts of Purchase, for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences and residences in certain Presidentially-declared disaster areas that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (with respect to New 1997/1998 Revenue Bonds Contracts of Purchase, for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation. All mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to may be made to borrowers whose family income does not exceed such 140% (or 120%) limitations.

Federal tax law applicable to the New 1997/1998 Revenue Bonds Contracts of Purchase permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Before a Contract of Purchase is financed, the Department verifies compliance with the requirements described under this caption "Loan Eligibility Requirements Imposed by the Tax

and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. The Department verifies compliance with the first-time homebuyer requirement by having veterans subject to this requirement so certify when applying for an Existing Contract or a New 1997/1998 Revenue Bonds Contract of Purchase, and the Program Documents require or required that a reasonable investigation be made to verify such certification. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Department verifies compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas or residences in certain Presidentially-declared disaster areas. The Department verifies compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (with respect to New 1997/1998 Revenue Bonds Contracts of Purchase, for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences and residences in certain Presidentially-declared disaster areas that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (with respect to New 1997/1998 Revenue Bonds Contracts of Purchase, for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation. All mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to may be made to borrowers whose family income does not exceed such 140% (or 120%) limitations.

Federal tax law applicable to the New 1997/1998 Revenue Bonds Contracts of Purchase permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Before a Contract of Purchase is financed, the Department verifies compliance with the requirements described under this caption "Loan Eligibility Requirements Imposed by the Tax

mortgage bonds), that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, the limit is based on statutory formula. The Offered Revenue Bonds and the 1997 Veterans G.O. Bonds are each within the applicable limit for the Department. The second general requirement of the Tax Code which is applicable to the Offered Revenue Bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The Department has covenanted to comply with such requirements to the extent required by the Tax Code.

The Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report. The Department has covenanted to file, as required, such reports with respect to the Offered Revenue Bonds and the 1997 Veterans G.O. Bonds.

The Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125%, (1.50% for certain prior Revenue Bonds) (other than the Allocated Prior Revenue Bonds Contracts of Purchase) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS—The 1943 Fund" and "THE PROGRAM—Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision. For certain mortgage loans made after December 31, 1990 from the proceeds of qualified mortgage bonds issued after August 15, 1986, and for assumptions of such mortgage loans, the Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the house (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the house were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision. The Department has established procedures which the Department believes has enabled it to meet, and will enable it to continue to meet, such recapture information requirement.

Veterans' Provisions. The Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply or applied for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established procedures and has covenanted to comply with such requirement.

The Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, the veterans provisions and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, *except* for a \$250,000 *de minimis* amount. As a result, the Department is required by the Tax Code to redeem the Offered Revenue Bonds and 1997 Veterans G.O. Bonds from repayments (including prepayments) of principal of certain 1997/1998 Revenue Bonds Contracts of Purchase not later than the close of the semi-annual period after the payment is received. See "THE OFFERED REVENUE BONDS — Redemption — Mandatory Redemption from Available Restricted Recoveries.

Compliance. The Department included provisions in the Program Documents that establish procedures, including receipt of certain affidavits from veterans, in order to assure compliance with the loan eligibility requirements and other requirements that must be satisfied subsequent to the date of issuance of the Offered Revenue Bonds and 1997 Veterans G.O. Bonds. The Department has covenanted in the Resolution to do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid on the Offered Revenue Bonds and 1997 Veterans G.O. Bonds shall not be included in gross income for federal income tax purposes and, for such purpose, to adopt and maintain appropriate procedures.

Opinions of the Attorney General and Bond Counsel

In the opinions of the Attorney General and of Hawkins, Delafield & Wood, Bond Counsel (expected to be delivered in substantially the forms set forth in Exhibit E), under existing statutes and court decisions, (i) interest on the Offered Revenue Bonds is not included in gross income for federal income tax purposes pursuant to Section 103 of the Tax Code, (ii) interest on the 1997 Series B Bonds, 1997 Series C Bonds, and 1998 Series A Bonds is treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Tax Code with respect to individuals and corporations, and (iii) interest on the 1997 Series A Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Tax Code with respect to individuals and corporations; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering such opinion, the Attorney General and Bond Counsel assume compliance by the Department with and enforcement by the Department of the Resolution and the applicable Program Documents. Bond Counsel has also relied upon the approving opinion of Orrick Herrington & Sutcliffe LLP with respect to the 1997 Veteran G.O. Bonds as to the validity and legality of such bonds and as to the exclusion of the interest thereon from gross income of the owners thereof for federal income tax purposes. The Attorney General and Bond Counsel express no opinion as to the exclusion from gross income of interest on any

Offered Revenue Bond subsequent to any date on which action is taken pursuant to the Resolution for which action the Resolution requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless the Attorney General and such firm delivers an opinion as of such date to such effect.

Certain Additional Federal Tax Consequences

The following is a brief discussion of certain federal income tax matters with respect to the Offered Revenue Bonds under existing statutes. It does not purport to deal with all aspects of federal taxation that may be relevant to a particular owner of an Offered Revenue Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the federal tax consequences of owning and disposing of the Offered Revenue Bonds.

As noted above, interest on the 1997 Series A Bonds must be taken into account in determining the tax liability of corporations subject to the federal alternative minimum tax imposed by Section 55 of the Code, and interest on the 1997 Series B Bonds, 1997 Series C Bonds, and 1998 Series A Bonds is a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Code. Interest on the Offered Revenue Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Owners of Offered Revenue Bonds should be aware that the ownership of such obligations may result in collateral federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. For example, several bills were introduced (but not enacted) during the 104th Congress to extend the environmental tax imposed by Section 59A of the Code with respect to taxable years beginning before January 1, 1996. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Revenue Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Revenue Bonds.

State Tax Matters

The Attorney General and Bond Counsel are of the opinion that the interest on the Offered Revenue Bonds is exempt from personal income taxes of the State of California under present State law.

VERIFICATION OF MATHEMATICAL ACCURACY OF CERTAIN COMPUTATIONS WITH RESPECT TO THE PRIOR REVENUE BONDS

Deloitte & Touche LLP will verify from the information provided to them the mathematical accuracy as of the date of the closing of the 1997 Series A Bonds, 1997 Series B Bonds and 1997 Series C Bonds of the computations contained in the provided schedules to determine that the anticipated receipts from the securities and cash deposits listed in such schedules, to be held in escrow, will be sufficient to pay, when due, the principal, interest and call premium payment requirements, if any, of the Prior Revenue Bonds. Deloitte & Touche LLP will express no opinion on the assumptions provided to them.

LITIGATION

At the time of the delivery of and payment for the Offered Revenue Bonds, the Department shall deliver, or cause to be delivered (1) a certificate of the Attorney General of the State to the effect that, to the best of his knowledge, no material litigation is pending or threatened in any court to restrain or enjoin the issuance or delivery of any of the Offered Revenue Bonds or the collection of Revenues or in any way contesting or affecting any authorization for, or the validity of, the Offered Revenue Bonds or the Resolution; and that, with respect to the officers who executed the Offered Revenue Bonds on behalf of the Department, to the best of his knowledge, the title of said officers to their respective offices is not being contested or questioned, and (2) an opinion of Chief Counsel to the Department to the effect that, to the best of his knowledge, other than as described in the following paragraph, no litigation is pending or threatened against the Department involving any of the property or assets of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account that involves the possibility of any judgment or uninsured liability which may result in any material adverse change in the business, properties, assets or in the condition, financial or otherwise, of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account; and that, with respect to the officers who executed the Offered Revenue Bonds on behalf of the Department, to the best of his knowledge, the title of said officers to their respective offices is not being contested or questioned.

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department cancelled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, over \$100 million was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Discovery is currently being conducted.

John L. Debbs and his wife have filed a separate federal court action (entitled *John L. Debbs and Patsy R. Debbs v. Jay Vargas, et al.*) (United States Federal Court, Eastern District of California, Case No. Civ-S-97-0123) against the Department, the Pacific Mutual Life Insurance Company, several California Veterans Board Members and two Department employees as individuals. The claims allege violation of constitutional rights, fraud, conspiracy, violation of equal protection, slander, bad faith, breach of fiduciary duty; "arbitrage violations" and other purported misdeeds. The complaint covers a period of approximately twenty years and requests a restraining order, injunctive relief, a receivership of the 1943 Fund and the Program, criminal relief and general, compensatory, punitive, prospective, consequential and special damages of over \$3,550,000. Motions to dismiss are scheduled for mid-December.

The Department is vigorously opposing both of these lawsuits. While the outcome of any litigation cannot be predicted with certainty, the Department expects to ultimately prevail in both of these lawsuits. Even if the plaintiff should prevail in both lawsuits, the Department does not expect such outcome to affect its ability to make timely payment of debt service on the Revenue Bonds.

UNDERWRITING

The Offered Revenue Bonds are being purchased by the Underwriters listed on the front cover page. The Underwriters have jointly and severally agreed to purchase the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds on or about December 29, 1997 for a purchase price of \$120,990,000 plus accrued interest, and in connection therewith the Department will pay a fee to the Underwriters of \$511,814.43. The Underwriters have jointly and severally agreed to purchase the 1998 Series A Bonds on or about May 5, 1998 for a purchase price of \$154,065,000, and in connection therewith the Department will pay a fee to the Underwriters of \$1,003,677.02. The initial public offering prices of the Offered Revenue Bonds may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Revenue Bonds provides that the Underwriters will purchase all the Offered Revenue Bonds if any are purchased, and that the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance, sale and delivery of the Offered Revenue Bonds to the Underwriters are subject to the approval of The Honorable Daniel E. Lungren, Attorney General of the State of California, and of Hawkins, Delafield & Wood, Bond Counsel. The respective issuances and acceptances of the Offered Revenue Bonds are conditioned upon delivery by Bond Counsel of the applicable approving opinion in substantially the applicable form set forth in Exhibit E hereto. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock.

Events occurring between the date of this Official Statement and the date of issuance of the 1998 Series A Bonds, including changes in State law or federal tax law, may affect the ability of Bond Counsel to deliver the approving legal opinion with respect to the 1998 Series A Bonds in the applicable form set forth in Exhibit E. Delivery of an approving legal opinion in substantially such form is a condition to the issuance of the 1998 Series A Bonds.

FINANCIAL STATEMENTS

The financial statements of the 1943 Fund as of June 30, 1997 and June 30, 1996 and for the years then ended, have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their reports appearing therein.

LEGALITY FOR INVESTMENT

The Act provides that the Offered Revenue Bonds shall be legal investments in California for all trust funds, funds of all insurance companies, banks (both commercial and savings), trust companies, state school funds, and pension funds, public or private. The Act also provides that any money or funds which may by law be invested in bonds of the State may be invested in the Offered Revenue Bonds and that whenever any bonds of the State may by law be used as security for the performance of any act or the deposit of any public money, the Offered Revenue Bonds may be so used.

RATINGS

Fitch, Moody's, and S&P have given the 1997 Series A Bonds, and 1997 Series B Bonds the ratings of A+, Aa3, and A+, respectively. Fitch, Moody's and S&P have given the 1998 Series A

Bonds the ratings of AAA, Aaa and AAA, respectively, in reliance upon the 1998 Series A Municipal Bond Insurance Policy. Fitch, Moody's and S&P have given the 1997 Series C Bonds the ratings of A+/F1+, Aa3/VMIG1, and A+/A-1+, respectively, until the Mandatory Tender Date on which the interest rate on such 1997 Series C Bonds is converted to a fixed interest rate to their maturity. Such ratings reflect only the view of such organizations and an explanation of the significance such ratings may be obtained from them. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely, if in the judgment of the respective rating agencies circumstances so warrant. Any such downward revision or withdrawal of any of such ratings may have an adverse effect on the market price of the applicable Offered Revenue Bonds.

CONTINUING DISCLOSURE

The Department has covenanted in a Master Continuing Disclosure Undertaking (the "Master Continuing Disclosure Undertaking"), for the benefit of the Bondowners and Beneficial Owners (each as defined in Exhibit B) of the Offered Revenue Bonds, to provide certain financial information and operating data relating to the Department (the "Annual Financial Information") by not later than the first day of the tenth calendar month following the end of the Department's then-current fiscal reporting period, commencing with the reporting period ending June 30, 1997, and to provide notices of the occurrence of certain enumerated events, if material. The Master Continuing Disclosure Undertaking requires that the Annual Financial Information be filed by the Department with the Trustee, with the State information depository (the "SID"), if any, and with each nationally recognized municipal securities information repository (each, an "NRMSIR"). The Master Continuing Disclosure Undertaking requires that notices of material events be filed by the Department with the Trustee, with the SID and with either of each NRMSIR or the Municipal Securities Rulemaking Board. The specific nature of the information to be contained in the Annual Financial Information or the notices of material events is summarized in Exhibit C—"SUMMARY OF CERTAIN PROVISIONS OF THE MASTER CONTINUING DISCLOSURE UNDERTAKING." These covenants have been made in order to assist the Underwriters in complying with Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission (the "Rule"). The Offered Revenue Bonds and the 1997 Veterans G.O. Bonds will be the first series of bonds of the Department which are subject to the continuing disclosure requirements of the Rule.

[the balance of this page is intentionally left blank]

MISCELLANEOUS

The information set forth herein is subject to change without notice and no implication should be derived therefrom or from the sale of the Offered Revenue Bonds that there has been no change in the affairs of the Department after the date hereof. The distribution of this Official Statement has been duly authorized by the Department. Any statement in this Official Statement involving matters of opinion, whether or not expressly so stated, is intended as such, and not as a representation of fact. Concurrently with the delivery of the Offered Revenue Bonds, the Department will furnish a certificate to the effect that this Official Statement, as of its date and as of the date of delivery of the Offered Revenue Bonds, does not and will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements herein, in the light of the circumstances under which they were made, not misleading. The agreement of the Department with the holders of the Offered Revenue Bonds is set forth in the Resolution. This Official Statement is not to be construed as an agreement or contract between the Department and the purchaser or holder of any of the Offered Revenue Bonds. Additional information may be obtained from the Department at 1227 "O" Street, Sacramento, California 95814, Attention: Bond Finance Division.

DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA

By /s/ Jay R. Vargas
Secretary of Veterans Affairs

Dated: December 10, 1997

(THIS PAGE INTENTIONALLY LEFT BLANK)

EXHIBIT A

**FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 1996 AND 1997
AND INDEPENDENT AUDITOR'S REPORT**

**VETERANS FARM AND HOME BUILDING
FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA**

Financial Statements for the Years Ended June 30, 1997
and 1996 and Independent Auditors' Report

(THIS PAGE INTENTIONALLY LEFT BLANK)



INDEPENDENT AUDITORS' REPORT

Department of Veterans Affairs
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California (Fund) as of June 30, 1997 and 1996, and the related statements of revenues, expenses and changes in retained earnings, and of cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to above present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California as of June 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

September 12, 1997

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

BALANCE SHEETS
JUNE 30, 1997 AND 1996 (in thousands)

ASSETS	1997	1996
Cash in State Treasury	\$ 12,773	\$ 14,114
Investments:		
Unrestricted	675,517	642,474
Restricted	327,190	470,196
Insurance administrators	<u>49,120</u>	<u>58,693</u>
	1,051,827	1,171,363
Total cash and investments	1,064,600	1,185,477
Receivables under contracts of sale, net of allowance for uncollectible contracts of \$26,412 and \$15,801 in 1997 and 1996, respectively	2,127,730	2,216,193
Due from Veterans Debenture Revenue Fund	86,279	137,141
Interest receivable:		
State of California's Surplus Money Investment Fund	477	2,986
Investments	17,766	21,995
Due from other funds	4,353	1,210
Other real estate owned	51,035	57,155
Land, improvements and equipment, net of accumulated depreciation of \$5,244 and \$6,996 in 1997 and 1996, respectively	7,834	8,437
Other	<u>976</u>	<u>1,120</u>
TOTAL ASSETS	<u>\$3,361,050</u>	<u>\$3,631,714</u>
LIABILITIES AND RETAINED EARNINGS		
LIABILITIES:		
Accrued interest and other liabilities	\$ 80,502	\$ 86,716
Bonds payable - net	2,953,312	3,181,518
Insurance claims payable and loss reserves	<u>69,083</u>	<u>82,840</u>
Total liabilities	3,102,897	3,351,074
RETAINED EARNINGS	<u>258,153</u>	<u>280,640</u>
TOTAL LIABILITIES AND RETAINED EARNINGS	<u>\$3,361,050</u>	<u>\$3,631,714</u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
YEARS ENDED JUNE 30, 1997 AND 1996 (in thousands)

	1997	1996
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of sale of properties	\$ 175,186	\$ 182,636
Investments and other	71,105	84,325
Transfers of interest revenue from Veterans Debenture Revenue Fund	<u>10,843</u>	<u>11,144</u>
Total program operations revenues	257,134	278,105
Expenses:		
Interest expense	230,871	245,971
Provision for contract losses	<u>22,677</u>	<u>5,515</u>
Total program operations expenses	<u>253,548</u>	<u>251,486</u>
Excess of program operations revenues and transfers over interest expense and provision for contract losses	<u>3,586</u>	<u>26,619</u>
PROGRAM ADMINISTRATION:		
Revenues:		
Loan servicing fees	1,385	1,426
Other income	905	343
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	<u>326</u>	<u> </u>
Total program administration revenues	2,616	1,769
Expenses:		
Payroll and related costs	11,342	10,885
General expenses	8,876	7,925
Excess of fire and hazard insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders		538
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	<u>162</u>	<u>10,239</u>
Total program administration expenses	<u>20,380</u>	<u>29,587</u>
Excess of program administration expenses over program administration revenues	<u>(17,764)</u>	<u>(27,818)</u>
LOSS ON SALE OF REPOSSESSED PROPERTY	<u>(8,309)</u>	<u>(5,510)</u>
DEFICIENCY OF REVENUES AND TRANSFERS OVER EXPENSES	(22,487)	(6,709)
RETAINED EARNINGS:		
Beginning of year	<u>280,640</u>	<u>287,349</u>
End of year	<u>\$ 258,153</u>	<u>\$ 280,640</u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 1997 AND 1996 (in thousands)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES:		
Deficiency of revenues and transfers in over expenses	\$ (22,487)	\$ (6,709)
Adjustments to reconcile to net cash used by operating activities:		
Amortization of bond premiums, discounts and issuance costs	(46)	(36)
Depreciation expense	716	849
Loss on sale of repossessed property	8,309	5,510
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus		
Money Investment Fund	2,509	692
Interest receivable - investments	(5,162)	(911)
Due from other funds	4,229	(185)
Other real estate owned	(2,189)	(21,742)
Other assets	144	75
Accrued interest and other liabilities	(6,214)	(4,152)
Insurance claims payable and loss reserves	<u>(13,757)</u>	<u>(3,752)</u>
Net cash used by operating activities	<u>(33,948)</u>	<u>(30,361)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in receivables under contracts of sale	90,778	125,559
Net decrease in investment securities	117,221	163,866
Purchase of land, improvements and equipment	<u>(113)</u>	<u>(112)</u>
Net cash provided by investing activities	<u>207,886</u>	<u>289,313</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in Due from Veterans Debenture Revenue Fund	52,881	25
Early redemption of bonds payable	(30,000)	(44,100)
Maturities on bonds payable	<u>(198,160)</u>	<u>(205,355)</u>
Net cash used by financing activities	<u>(175,279)</u>	<u>(249,430)</u>
INCREASE (DECREASE) IN CASH IN STATE TREASURY	(1,341)	9,522
CASH IN STATE TREASURY:		
Beginning of year	<u>14,114</u>	<u>4,592</u>
End of year	<u>\$ 12,773</u>	<u>\$ 14,114</u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Cash and Investments - Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments. Investments in U.S. Treasury notes and bonds are carried at par, net of unamortized discounts and premiums. The discounts and premiums are amortized through the maturity dates of the underlying securities. The investments in the State of California's Surplus Money Investment Fund and investment agreements are carried at cost which approximates market value.

Receivables Under Contracts of Sale - Receivables under contracts of sale consist of the remaining contract principal balance plus unpaid interest accrued to date, net of the reserve for uncollectible accounts. The contract balance may also include amounts paid by the Fund for property taxes and insurance pending reimbursement from the contract holder.

Reserve for Uncollectible Accounts - The reserve for uncollectible accounts is established through a provision charged to operations. The reserve is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Other Real Estate Owned - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported (INBR) claims and loss reserves for the Fire and Hazard Insurance Plan and the benefits payable under the Department's remaining self-insured life and disability protection plan.

Fire and Hazard Insurance - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan - From January 1, 1984 to June 1, 1996, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. The Department's self-insured life and disability protection plan was terminated effective June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were actuarially determined using a long-term discount rate of 7%. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability and prepayment.

Amortization of Bond Premiums, Discounts and Issuance Costs - Premiums and discounts arising from the issuance of bonds are amortized on a method which approximates the effective interest method. Expenses incurred in connection with the issuance of bonds are capitalized and amortized using the straight-line method.

Retirement Plan - The Department adopted Statement No. 27 of the Governmental Accounting Standards Board, *Accounting for Pensions by State and Local Government Employers*, effective for the fiscal year ended June 30, 1997.

Reclassifications - Certain 1996 amounts have been reclassified to conform with the 1997 presentation.

2. CASH AND INVESTMENTS

Cash in the State Treasury of \$12,772,900 and \$14,114,000 as of June 30, 1997 and 1996, respectively, represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law.

The Fund's investment in investment agreements of \$365,542,000 is carried at cost, which is equal to the value at expiration and approximates fair value. The interest rates on investment agreements are fixed at 6.64%, 7.66% and 7.66%, and expire on March 30, 1998, January 30, 1998, and July 30, 2019, respectively.

All of the Fund's investments in U.S. Treasury notes and bonds and the amounts administered by the insurance company are categorized as risk category 1, which is defined by the Governmental Accounting Standards Board (GASB) Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized because they are not evidenced by securities that exist in physical or book entry form.

The Fund's investments at June 30, 1997 and 1996 are as follows (in thousands):

	1997		1996	
	Carrying Amount	Approximate Market Value	Carrying Amount	Approximate Market Value
Category 1:				
U.S. Treasury notes and bonds	\$ 332,760	\$ 347,214	\$ 355,900	\$ 363,426
Amounts held in trust fund with insurance administrators:				
U.S. Treasury notes	16,002	16,729	23,943	23,379
Corporate bonds	21,694	21,096	25,065	25,622
Other	7,688	7,689	6,427	6,409
Investments Not Subject to Categorization:				
State of California's Surplus Money Investment Fund	304,405	304,405	281,026	281,027
Investment agreements	365,542	365,542	475,744	475,744
Amounts held in trust fund with insurance administrators:				
Mutual fund	<u>3,736</u>	<u>5,098</u>	<u>3,258</u>	<u>3,876</u>
	<u>\$1,051,827</u>	<u>\$1,067,773</u>	<u>\$1,171,363</u>	<u>\$1,179,483</u>

3. RECEIVABLES UNDER CONTRACTS OF SALE

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 9.0%, depending on the age and type of contract and the classification of the current contract holder.

4. BONDS PAYABLE

At June 30, 1997 and 1996, bonds payable included the following (in thousands):

	1997	1996
General obligation bonds of the State of California, annual interest rates from 3.5% to 11.0% due in varying annual installments through 2027 (subject to varying redemption provisions)	\$2,632,045	\$2,812,810
Home purchase revenue bonds, annual interest rates from 6.1% to 8.3%, due in varying annual installments through 2019 (subject to varying redemption provisions)	<u>327,580</u> 2,959,625	<u>374,975</u> 3,187,785
Discounts	(8,492)	(8,592)
Premiums	<u>2,179</u>	<u>2,325</u>
Total	<u>\$2,953,312</u>	<u>\$3,181,518</u>

Future scheduled bond maturities at June 30, 1997 are as follows (in thousands):

1998	\$ 187,525
1999	193,360
2000	204,865
2001	207,940
2002	212,535
Thereafter	<u>1,953,400</u>
	<u>\$2,959,625</u>

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1990 and 1996 are \$654,370,000 at June 30, 1997.

Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the \$1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 1997 and 1996, authorized and unissued revenue bonds were \$1,172,420,000 and \$1,125,025,000, respectively.

The revenue bond resolutions require that an amount equal to 10% of the aggregate of the initial principal amount of all series of revenue bonds outstanding (the "Bond Reserve Requirement") be established in the Veterans Debenture Revenue Fund (a separate entity). If a revenue bond series is retired or matures in its entirety, the bond reserve requirement decreases. The investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund each year as provided by the revenue bond resolutions. Amounts in the Veterans Debenture Revenue Fund are restricted to paying the principal, interest and mandatory sinking fund payments on the revenue bonds or for retiring all revenue bonds then outstanding. At June 30, 1997 and 1996, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

5. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to \$1,500,000 per occurrence or \$13,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess (deficiency) of premiums charged to contract holders over (under) claims, expenses and change in loss reserves for the year ended June 30, 1997 and 1996 was as follows (in thousands):

	1997	1996
Amounts charged to contract holders	\$ 10,344	\$ 11,144
(Less) plus:		
Decrease in estimated loss reserve	1,339	2,269
Claims loss expense	(9,907)	(12,134)
Master policy premium	(622)	(619)
Administrative fees	<u>(828)</u>	<u>(1,198)</u>
Excess (deficiency) of amounts charged to contract holders over (under) claims and expenses and changes in reserves	\$ <u>326</u>	\$ <u>(538)</u>

6. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department's self-insured life and disability protection plan was replaced on June 1, 1996, by a life and disability insurance plan provided by Pacific Mutual Group (PMG). Under the plan all Cal-Vet loan holders previously in the self-insured program were provided an opportunity to contract for the PMG plan regardless of age or health status. All new contract holders after the effective date are required to apply for this insurance.

At the time the Department's self-insured protection plan ended, approximately 1,727 contract holders were receiving disability benefits in the amount of their monthly loan payment at the time of their disability. As of June 30, 1997, approximately 1,500 contract holders were receiving disability and life benefits under the self-insured life and disability protection plan. These benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment, dies, or their contract is paid off.

Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were \$3,732,472 and \$4,815,000 in 1997 and 1996, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 1997 and 1996 was as follows (in thousands):

	1997	1996
Claims expenses:		
Life insurance program	\$ (1,564)	\$ (9,858)
Disability insurance program	<u>(10,843)</u>	<u>(10,513)</u>
Total claims expenses	(12,407)	(20,371)
Decrease in estimated loss reserves	<u>12,418</u>	<u>1,483</u>
Net claims expenses and change in loss reserves	11	(18,888)
Plus plan revenues:		
Life insurance program	205	4,726
Disability insurance program	<u>224</u>	<u>5,289</u>
Total	429	10,015
Less administrative fees	<u>(602)</u>	<u>(1,366)</u>
Excess of net claims expenses, change in loss reserves and administrative fees over plan revenues	<u>\$ (162)</u>	<u>\$ (10,239)</u>

7. COMMITMENTS AND CONTINGENCIES

As of June 30, 1997 and 1996, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately \$2,307,000 and \$11,828,000, respectively.

The Department is a defendant in certain litigation related to the self-insured Life and Disability Protection Plan, formerly operated by the Department, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 1997 and 1996 was \$482,057 and \$502,280, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 1997, minimum annual rentals under operating leases are as follows (in thousands):

1998	\$ 391,992
1999	325,678
2000	265,380
2001	265,380
2002	219,828
Thereafter	<u>112,874</u>
	<u>\$1,581,132</u>

8. RETIREMENT PLAN

The Department, through the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Fund are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 94229-2715.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$238 to \$863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

For the fiscal years ended June 30, 1996 and June 30, 1997, the required State contribution rates ranged from 9.35% to 13.11%. Contributions by the Department to the Plan for the years ended June 30, 1997 and 1996 were approximately \$1,042,000 and \$987,000, or approximately 9.2% and 9.0% of participants salaries, respectively. Employee contributions to the Plan for the years ended June 30, 1997 and 1996 were approximately \$305,000 and \$315,000 or approximately 2.7% and 2.9% of participants salaries, respectively.

For fiscal years ended June 30, 1997 and 1996, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1995 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.5% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 4.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The underfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1995 was 34 years.

Three-Year Fund Trend Information

Fiscal Year-End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1995	\$814,000	100%	\$0
June 30, 1996	\$987,000	100%	\$0
June 30, 1997	\$1,042,000	100%	\$0

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress
For the Past Three Years for the
CalPERS State PERS Plans *
(In millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Entry Age (b)	Underfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Estimated Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1994	\$32,294	\$36,055	\$3,761	89.6%	\$8,070	46.6%
June 30, 1995	\$34,689	\$39,219	\$4,530	88.5%	\$8,659	52.3%
June 30, 1996	\$38,917	\$41,867	\$2,950	93.0%	\$8,924	33.1%

*Department and Fund information is not separately available.

9. **SUBSEQUENT EVENTS**

During August 1997, the Fund called approximately \$1,810,000 of revenue bonds and approximately \$4,950,000 of general obligation bonds pursuant to the terms and early call provisions of the bond agreements.

* * * * *

(THIS PAGE INTENTIONALLY LEFT BLANK)

EXHIBIT B

MANDATORY SINKING ACCOUNT PAYMENTS

<u>Date (December 1)</u>	<u>1997A 2028 Term Bonds</u>	<u>1997 B 2018 Term Bonds</u>	<u>1998 Series A PAC Bonds</u>	<u>1998 Series A Super Sinker Bonds</u>
1998			\$1,785,000	\$ 1,865,000
1999			1,870,000	1,955,000
2000			1,980,000	2,070,000
2001			2,095,000	2,195,000
2002			2,220,000	2,320,000
2003			2,350,000	2,455,000
2004			2,485,000	2,600,000
2005			2,630,000	2,750,000
2006			2,785,000	2,910,000
2007			2,950,000	3,080,000
2008			3,120,000	3,265,000
2009		\$485,000	3,305,000	3,455,000
2010		515,000	3,500,000	3,655,000
2011		545,000	3,705,000	3,870,000
2012		580,000	3,920,000	4,095,000
2013		615,000	4,145,000	4,335,000
2014		655,000	4,390,000	4,585,000
2015		695,000	4,645,000	4,855,000
2016		740,000	4,915,000	5,140,000
2017		785,000	5,200,000	5,440,000
2018		835,000†	5,505,000†	5,755,000
2019	\$ 100,000			11,915,000†
2020	100,000			
2021	4,600,000			
2022	100,000			
2023	4,700,000			
2024	100,000			
2025	100,000			
2026	100,000			
2027	100,000			
2028	805,000†			

† Stated maturity.

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUMMARY OF CERTAIN PROVISIONS OF THE MASTER CONTINUING DISCLOSURE UNDERTAKING

Certain provisions of the Master Continuing Disclosure Undertaking of the Department not previously discussed in this Official Statement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Master Continuing Disclosure Undertaking.

The Master Continuing Disclosure Undertaking, expected to be dated as of the date of delivery of the 1997 Series A Bonds, 1997 Series B Bonds, and 1997 Series C Bonds, is to be executed and delivered by the Department for the benefit of the Bondowners and the Beneficial Owners and in order to assist the Participating Underwriters in complying with SEC Rule 15c2-12(b)(5).

Certain Definitions

Defined terms used in the Master Continuing Disclosure Undertaking and not otherwise defined therein have the meanings set forth in the Resolution.

"Beneficial Owner" means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

"Bonds" means, at any time, all of the Department's then Outstanding Home Purchase Revenue Bonds, collectively.

"Fiscal Year" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Master Continuing Disclosure Undertaking, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"Bondowners" means the registered owners of the Subject Bonds.

"Listed Event" means any of the events listed below under the heading "Reporting of Certain Events."

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934.

"Notice" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"Notice Address" means with respect to the Department:

State of California Department of Veterans Affairs
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

"NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"Official Statement" means this Official Statement.

"Participating Underwriter" means any of the original underwriters of any Subject Bonds required to comply with the Rule in connection with the offering of such Subject Bonds.

"Rule" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, §240.15c2-12), as in effect on the date of the Master Continuing Disclosure Underwriting including any official interpretations thereof.

"SEC" means the United States Securities and Exchange Commission.

"Securities Counsel" means legal counsel expert in Federal securities laws.

"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.*

"Subject Bonds" means those Bonds with respect to which the terms of the Master Continuing Disclosure Undertaking are expressly incorporated into any one of the Department documents authorizing the issuance of such Bonds.

Provision of Annual Financial Information

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 1996-1997 Fiscal Year, provide to the Trustee and to each NRMSIR and the SID the Annual Financial Information. The audited financial statements of the Department and of the Bond Reserve Account and Loan Loss Account may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Master Continuing Disclosure Undertaking requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the Trustee and to either (i) each NRMSIR or (ii) the MSRB.

Content of Annual Financial Information

The Department's Annual Financial Information shall contain or include by reference the following:

(a) the audited financial statements of the 1943 Fund and of the Bond Reserve Account and Loan Loss Account for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year; and

(b) financial information or operating data of the types included in Exhibit D of this Official Statement entitled "Certain Department Financial Information and Operating Data."

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the Trustee and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Department or related public entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Reporting of Certain Events

The Department will give notice to the Trustee and to the SID and to either each NRMSIR or the MSRB of the occurrence of any of the following events with respect to the Subject Bonds:

If this Official Statement, there is no SID.

- (1) principal and interest payment delinquencies;
- (2) non-payment related defaults;
- (3) modification to rights of Bondowners;
- (4) Subject Bond calls;
- (5) unscheduled draws on credit enhancements reflecting financial difficulties;
- (6) substitution of credit or liquidity providers, or their failure to perform;
- (7) defeasances;
- (8) rating changes;
- (9) adverse tax opinions or events affecting the tax-exempt status (if applicable) of any Subject Bonds;
- (10) unscheduled draws on the debt service reserves reflecting financial difficulties; or
- (11) release, substitution or sale of property securing repayment of the Subject Bonds.

Additional Information

Nothing in the Master Continuing Disclosure Undertaking will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in the Master Continuing Disclosure Undertaking or any other means of communication, or including any other information in any Annual Financial Information or notice of occurrence of a Listed Event, in addition to that which is required by the Master Continuing Disclosure Undertaking. If the Department chooses to include any information in any Annual Financial Information or notice of occurrence of a Listed Event in addition to that which is specifically required by the Master Continuing Disclosure Undertaking, the Department will have no obligation under the Master Continuing Disclosure Undertaking to update such information or include it in any future Annual Financial Information or notice of occurrence of a Listed Event.

Amendment of Master Continuing Disclosure Undertaking

The Master Continuing Disclosure Undertaking may be amended and any provision of the Master Continuing Disclosure Undertaking be waived, without the consent of the Bondowners or Beneficial Owners, except as described in clause 4(ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature, or status of the Department or the type of business conducted thereby, (2) the Master Continuing Disclosure Undertaking as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have delivered to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as the Trustee or bond counsel), acceptable to the Trustee and the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the Bondowners consent to the amendment to or waiver of the Master Continuing Disclosure Undertaking pursuant to the same procedures as are required for amendments to the Resolution with consent of Bondowners, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the Trustee, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Master Continuing Disclosure Undertaking, and any provision of the Master Continuing Disclosure Undertaking may be waived, if the Trustee shall have received an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that the adoption and the terms of such amendment or waiver would not, in and of themselves, cause the undertakings in the Master Continuing Disclosure Undertaking to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Benefit; Enforcement

The provisions of the Master Continuing Disclosure Undertaking will inure solely to the benefit of the Bondowners and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Master Continuing Disclosure Undertaking will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Master Continuing Disclosure Undertaking are enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of Outstanding Subject Bonds, or by the Trustee on behalf of the Bondowners of Outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Trustee on behalf of the Bondowners of Outstanding Subject Bonds or by any Beneficial Owner; *provided, however*, that a Beneficial Owner may not take any enforcement action pursuant to clause (ii) without the consent of the Bondowners of not less than 20% in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Master Continuing Disclosure Undertaking is limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Master Continuing Disclosure Undertaking. Any failure by the Department to perform in accordance with the Master Continuing Disclosure Undertaking will not constitute a default or an Event of Default under the Resolution, and the rights and remedies provided by the Resolution upon the occurrence of a default or an Event of Default will not apply to any such failure.

Termination of Reporting Obligation

The Department's obligations under the Master Continuing Disclosure Undertaking with respect to the Subject Bonds terminate upon the legal defeasance under the Resolution, prior redemption, or payment in full of all of the Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Master Continuing Disclosure Undertaking, or any provision thereof, will be null and void to the extent set forth in the opinion of Securities Counsel described in clause (1) in the event that the Department (1) delivers to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that those portions of the Rule which require the provisions of the Master Continuing Disclosure Undertaking, or any of such provisions, do not or no longer apply to the Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion, and (2) delivers notice to such effect to the Trustee, to the SID and to either each NRMSIR or the MSRB.

Governing Law

The Master Continuing Disclosure Undertaking will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Master Continuing Disclosure Undertaking will be instituted in a court of competent jurisdiction in the State, *provided*

that, to the extent the Master Continuing Disclosure Undertaking addresses matters of Federal securities laws, including the Rule, the Master Continuing Disclosure Undertaking will be construed in accordance with such Federal securities laws and official interpretations thereof.

[the balance of this page is intentionally left blank]

(THIS PAGE INTENTIONALLY LEFT BLANK)

EXHIBIT D**CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA****Contracts of Purchase**

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of September 30, 1997, using proceeds of Veterans G.O. Bonds and Prior Revenue Bonds.

Current Loan-to-Value Ratio of Contracts of Purchase⁽¹⁾

	<u>Current Contracts of Purchase Balance (000s)</u>
Single Family Homes	
Less than 30% LTV	\$ 127,073
30-49% LTV	297,479
50-59% LTV	203,724
60-69% LTV	260,205
70-79% LTV	303,272
Sub-total	\$1,191,751
80-84% LTV	139,251
85-89% LTV	259,267
90-94% LTV	414,012
95-97% LTV	16,112
Sub-total	\$ 828,642
Other High LTV Contracts ⁽²⁾	26,265
Total	\$2,046,659
Other Property Types	
Farms	6,553
Mobile Homes in Parks	12,272
Total	\$ 18,824
Special Status Contracts of Purchase	
Real Estate Owned ⁽³⁾	65,422
Disability Program ⁽⁴⁾	59,267
Total	\$ 124,689
Total Portfolio	\$2,190,172

(1) LTV based on current Contracts of Purchase balance (net of accrued interest, advanced taxes and insurance) divided by original appraised value of property.

(2) Consists of Contracts of Purchase where delinquent accrued interest and charges have been added to Contracts of Purchase balance.

(3) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.

(4) Contracts of Purchase where payments are made on behalf of veteran by the Department's life and disability coverage plan.

Geographic Distribution of Contracts of Purchase

<u>County</u>	<u>Approximate Current Contract Balance (000s)</u>
Sacramento	\$ 242,277
Los Angeles	174,025
San Bernardino	166,789
Fresno	125,531
San Diego	117,991
Kern	117,851
Riverside	101,869
Orange	92,959
San Joaquin	66,943
Placer	60,796
Solano	56,065
Shasta	54,597
Contra Costa	52,044
Other Northern California Counties	431,044
Other Central California Counties	269,951
Other Southern California Counties	59,439
Statewide—California	<u>\$2,190,171*</u>

*Amounts may not total due to rounding.

Contracts of Purchase Origination and Principal Repayment Experience

The following tables present, respectively, a historical picture of Contract of Purchase originations since the 1984-85 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1977-1978 fiscal year.

New Contracts of Purchase During the Fiscal Year⁽¹⁾

<u>Fiscal Year Ending June 30</u>	<u>Veterans G.O. Bonds</u>		<u>Prior Revenue Bonds</u>		<u>Total</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
1985	4,196	\$290,885,900	2,301	\$154,244,600	6,497	\$445,130,500
1986	3,484	243,955,800	2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700	1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500	1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300	1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600	522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500	359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500	388	34,671,600	1,474	146,272,100
1993	740	94,417,100	286	27,443,800	1,026	121,860,900
1994	843	117,213,779	337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376	822	84,860,894	2,931	371,039,270
1996	762	107,751,444	222	22,723,617	984	130,475,061
1997	766	118,344,636	201	21,853,933	967	140,198,569
1998 ⁽²⁾	186	28,079,369	55	5,868,556	241	33,947,925

⁽¹⁾ Number of new Contracts of Purchase includes home improvement loans; dollar amounts exclude home improvement loans.

⁽²⁾ 3-month period through September 30, 1997.

**Selected Principal Flows with respect to Contracts of Purchase
Funded by both Veterans G.O. Bonds and Revenue Bonds**

Fiscal Year Ending June 30	Contracts Funded During Year (\$'000's)	Contract Payments During Year (\$'000's)	Other Principal Receipts—Losses During Year (\$'000's)	Contract Balance at End of Year (\$'000's)	Average Base Contract Rate	Rates			Annual Average Prepayment Rate	Annual Average Origination Rate
						Average of Monthly FTMILC 30-year Conventional Loan Rate	— %	— %		
1978	—	—	—	1,538,524	— %	—	—	—	— %	— %
1979	340,227	124,864	68,240	1,685,647	5.6	—	7.7	21.1		
1980	716,662	100,540	69,079	2,232,690	5.6	—	5.1	36.6		
1981	417,628	82,393	70,472	2,497,453	6.6	14.0	3.5	17.7		
1982	279,239	44,608	74,891	2,657,193	7.3	17.3	1.7	10.8		
1983	254,086	92,146	87,536	2,731,597	8.0	14.6	3.4	9.4		
1984	405,616	132,911	94,930	2,909,372	8.0	13.4	4.7	14.4		
1985	445,131	123,669	88,308	3,142,526	8.0	13.8	4.1	14.7		
1986	404,738	179,809	94,970	3,272,485	8.0	11.5	5.6	12.6		
1987	184,627	261,675	99,569	3,095,868	7.7	9.8	8.2	5.8		
1988	335,095	198,396	114,178	3,118,389	7.0	10.5	6.4	10.8		
1989	335,872	207,471	105,896	3,140,894	7.3	10.6	6.6	10.7		
1990	225,596	232,085	96,639	3,037,766	8.0	10.1	7.5	7.3		
1991	229,583	191,895	92,722	2,982,732	8.0	9.9	6.4	7.6		
1992	146,272	246,150	92,975	2,789,879	8.0	9.0	8.5	5.1		
1993	121,861	273,817	105,629	2,532,294	8.0	8.0	10.3	4.6		
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4		
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0		
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5		
1997	140,199	111,354	106,027	2,229,180	8.0	7.9	4.9	6.2		
1998 ⁽¹⁾	33,947	40,860	32,052	2,190,215	8.0	7.5	7.4	6.1		
	<u>5,669,847</u>	<u>3,258,044</u>	<u>1,760,113</u>							

⁽¹⁾ 3-month period through September 30, 1997.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following amounts following the issuance of the Offered Revenue Bonds, the 1997 Veterans G.O. Bonds and the 1998 Veterans G.O. Bonds are expected to become available to fund Contracts of Purchase. The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys are described under "THE PROGRAM—Qualifying Veteran Status." Additional moneys may become available to finance Contracts of Purchase through the future issuances of Revenue Bonds and Veterans G.O. Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses.

<u>Bond Series</u>	<u>Issuance Date or Expected Issuance Date</u>	<u>Respective Series Bond Proceeds Subaccounts</u>			<u>Investment</u>	<u>Investment Rate (%)</u>
		<u>Unrestricted Moneys⁽¹⁾</u>	<u>Qualified Veterans Mortgage Bond Proceeds⁽¹⁾</u>	<u>Qualified Mortgage Bond Proceeds⁽¹⁾</u>		
Veterans G.O. Bonds						
Series BC - BF	3/30/95	-0-	26,853	-0-	GIC ⁽²⁾	6.635
Series BG/BH/BK/BL	12/29/97 and 1/5/98	-0-	165,000	-0-	GIC ⁽³⁾	5.71
Series BJ ⁽⁹⁾	12/29/97	-0-	300,000	-0-	GIC ⁽⁴⁾	5.52
1984 Code QVMB Recycling Subaccount	N.A.	-0-	35,000	-0-	GIC ⁽³⁾	5.71
Unrestricted Recycling Subaccount	N.A.	60,585	-0-	-0-	⁽⁵⁾	N.A.
1998 Veterans G.O. Bonds	⁽¹⁰⁾	39,415	-0-	-0-	N.A. ⁽⁶⁾	N.A.
Total with respect to Veterans G.O. Bonds		<u>100,000</u>	<u>526,853</u>	<u>-0-</u>		
Revenue Bonds						
1997 Series C ⁽⁹⁾	12/29/97	-0-	-0-	93,000	GIC ⁽⁷⁾	5.57
Section 143 OMB Recycling Subaccount	N.A.	-0-	-0-	231,000	GIC ⁽⁸⁾	5.73
Total with respect to Revenue Bonds		<u>-0-</u>	<u>-0-</u>	<u>324,000</u>		
Total		<u>\$100,000</u>	<u>\$526,853</u>	<u>\$324,000</u>		

⁽¹⁾ 000s omitted.

⁽²⁾ Guaranteed investment contract with Societe Generale maturing March 30, 1998.

⁽³⁾ Expected to be invested in a guaranteed investment contract maturing December 1, 2000 with Societe Generale.

⁽⁴⁾ Expected to be invested in a guaranteed investment contract maturing June 1, 1999 with Societe Generale.

⁽⁵⁾ Invested in United States Treasury obligations and State of California Surplus Money Investment Fund.

⁽⁶⁾ No amounts currently on deposit.

⁽⁷⁾ Expected to be invested in a guaranteed investment contract maturing December 1, 1999 with Societe Generale.

⁽⁸⁾ Expected to be invested in a guaranteed investment contract maturing December 1, 2001 with Societe Generale.

⁽⁹⁾ Proceeds will become available only with respect to those bonds on which the interest rate has been adjusted to fixed interest rates to maturity.

⁽¹⁰⁾ 1998 Veterans G.O. Bonds expected to be available on or before May 5, 1998.

As of September 30, 1997, the Department had 144 pending applications in the aggregate amount of approximately \$13,000,000.

Cancellations and Delinquencies

Set forth in the table below is a five-year comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	<u>1993⁽¹⁾</u>	<u>1994⁽¹⁾</u>	<u>1995⁽¹⁾</u>	<u>1996⁽¹⁾</u>	<u>1997⁽¹⁾</u>	<u>1997⁽²⁾</u>
Percentage of Number of Contracts of Purchase						
Delinquent ⁽³⁾						
30-67 days	1.45%	0.99%	1.45%	2.90%	1.65%	0.89%
68+ days	2.77%	4.24%	3.12%	2.50%	3.22%	2.66%
Cancelled Contracts and Bankruptcies ⁽⁴⁾	0.23%	0.38%	0.64%	0.82%	0.94%	0.99%
Repossessed Contracts	0.20%	0.35%	0.64%	1.07%	0.92%	0.70%
USDVA Guaranteed Loans⁽⁵⁾						
Percentages in U.S.						
Delinquent						
30-60 days	4.19%	4.07%	4.14%	4.59%	4.58%	
60+ days	2.18%	2.25%	2.21%	2.20%	2.28%	
Foreclosures in inventory	1.35%	1.44%	1.26%	1.54%	1.81%	
Percentages in California						
Delinquent						
30-60 days	3.80%	3.42%	4.03%	4.23%	4.30%	
60+ days	2.56%	2.36%	2.53%	2.36%	2.52%	
Foreclosures in inventory	1.93%	2.28%	2.31%	3.18%	3.54%	

⁽¹⁾ As of June 18 for Department's data and June 30 for USDVA data.

⁽²⁾ Department information is as of September 30. USDVA information for this period is not currently available.

⁽³⁾ Time periods conform to Department's record-keeping system.

⁽⁴⁾ Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.

⁽⁵⁾ Source: National Delinquency Survey published by the Mortgage Bankers Association of America.

[the balance of this page is intentionally left blank]

Veterans G.O. Bonds and Prior Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Prior Revenue Bonds, including those expected to be redeemed, defeased or retired as a result of the issuance of the 1997 Veterans G.O. Bonds and the Offered Revenue Bonds.

Selected Information with Respect to Outstanding Veterans G.O. Bonds and Prior Revenue Bonds

Series	Bonds Outstanding as of 10/2/1997	Bonds Expected to be Outstanding as of 5/5/1998	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
Veterans G.O. Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
Prior Revenue Bonds							
PP	\$ 4,800,000	\$ 4,800,000	October 1, 1998	Non-callable	N.A.	N.A.	No
QQ	14,400,000	9,600,000	February 1, 2000	Non-callable	N.A.	N.A.	No
TT	10,800,000	— 1					
UU	24,000,000	— 2					
VV	18,000,000	— 2					
WW	42,600,000	— 1					
XX	28,400,000	— 2					
YY	49,200,000						
ZZ/AB	41,000,000	42,600,000	April 1, 2004	April 1, 1999	100%	5.900%	No
AC	41,000,000	41,000,000	August 1, 2004	August 1, 1999	100%	5.750%	No
AD	55,800,000	41,000,000	August 1, 2004	August 1, 1999	100%	5.700%	No
AE	29,760,000	49,200,000	April 1, 2005	April 1, 2000	100%	6.800%	No
AF	44,640,000	29,760,000	August 1, 2005	August 1, 2000	100%	7.000%	No
AG	55,800,000	44,640,000	August 1, 2005	August 1, 2000	100%	7.300%	No
		55,800,000	October 1, 2005	October 1, 2000	100%	8.250%	No
Sub-total	\$460,200,000	\$318,400,000					

Revenue Bonds Issued to Refund Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980

1991 A	\$30,180,000	— 3
Sub-total	\$30,180,000	

Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code

AH	\$ 60,000,000	August 1, 2006	August 1, 2001	100%	10.000%	No
AK	15,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL	50,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No

Series	Bonds Outstanding as of 10/2/1997	Bonds Expected to be Outstanding as of 5/5/1998	Final Maturity Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
Veterans G.O. Bond		Prior Revenue Bonds					

AM	\$ 65,000,000		October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP	93,000,000	\$ 65,000,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ	97,500,000	91,500,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR	47,500,000	97,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS	49,000,000	47,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT	219,855,000	49,000,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU	138,930,000	207,485,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV	95,170,000	138,930,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total	\$ 930,955,000	95,170,000					
		\$ 909,585,000					

Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code

AW	\$ 271,615,000	— ⁴					
AX/AY	240,500,000	— ³					
AZ/BA	256,700,000	— ³					
BC/BF ⁽⁵⁾	385,530,000	\$ 348,745,000	February 1, 2027	February 1, 1998	102%	6.550%	Allocated ⁽⁶⁾
Sub-total	\$1,154,345,000	\$ 348,745,000					

Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code

1986 A	\$107,600,000	— ³
1988 A	156,650,000	— ³
Sub-total	\$264,250,000	—
TOTAL	\$294,430,000	\$1,576,730,000

¹Bonds expected to be retired from amounts in the 1943 Fund on or about April 1, 1998.

² Bonds to be retired or defeased following expected sale and delivery of additional Veterans G.O. Bonds on or about May 5, 1998.

³ Bonds to be retired or defeased following issuance of Offered Revenue Bonds and the 1997 Veterans G.O. Bonds on or about December 29, 1997.

⁴ Bonds to be retired or defeased following issuance of Offered Revenue Bonds and the 1997 Veterans G.O. Bonds on or about January 5, 1998.

⁵ Includes Series BC, Series BD, Series BE and Series BF.

⁶ Subject to redemption at par from portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Revenue Bonds and Veterans G.O. Bonds) of Series to all outstanding bonds.

Additional Investments

In addition to the investments described above under "Contracts of Purchase—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," on or about December 29, 1997 the following investments are expected to be made with respect to moneys in the 1943 Fund and the Bond Reserve Account:

<u>Fund or Account Designation⁽¹⁾</u>	<u>Amount</u>	<u>Type of Investment</u>	<u>Investment Provider</u>	<u>Investment Maturity Date</u>	<u>Investment (%)</u>
1997/1998 Bond Reserve Subaccount	\$5,251,650 ⁽²⁾	GIC	Societe Generale	12/1/28	5.75
1997/1998 Revenue Subaccount and 1997/1998 Restricted Recoveries Subaccount	variable	GIC	Societe Generale	12/1/28	5.91
Series BG/BH/BK/BL Revenue Subaccount and Series BG/BH/BK/BL Recycling Subaccount ⁽³⁾	variable	GIC	Societe Generale	12/1/32	5.91

⁽¹⁾ See "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION—Establishment of Accounts (Section 401)."

⁽²⁾ \$1,469,300 of this amount represents all of the amounts established with respect to the 1997 Series A Bonds and 1997 Series B Bonds, and the balance represents the amount (which can be withdrawn if the expected issuance of the 1998 Series A Bonds does not occur) established with respect to the 1998 Series A Bonds.

⁽³⁾ Maximum permitted amount on deposit at any one time is \$250,000,000.

[the balance of this page is intentionally left blank]

EXHIBIT E

PROPOSED FORMS OF OPINION OF ATTORNEY GENERAL AND BOND COUNSEL

***PROPOSED FORM OF OPINION WITH RESPECT TO THE 1997 SERIES A BONDS,
1997 SERIES B BONDS AND 1997 SERIES C BONDS***

[closing date]

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as Attorney General of the State of California and as bond counsel, respectively, and in such capacities we have examined upon request copies of proceedings taken by the Department of Veterans Affairs of the State of California (the "Department") in connection with the issuance of the Department's Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, and 1997 Series C (respectively, the "1997 Series A Bonds," the "1997 Series B Bonds," and the "1997 Series C Bonds," and, collectively, the "Bonds"), in the aggregate principal amount of \$120,990,000, and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), and (4) the Ninth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$294,430,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A, adopted November 24, 1997 and amended December 22, 1997 (the "Ninth Supplemental Resolution"). The Resolution of Issuance, the Eighth Supplemental Resolution and the Ninth Supplemental Resolution, are collectively referred to herein as the "Resolution."

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, are subject to mandatory tender, and are payable as provided in the Resolution. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolution.

The Department expects to issue its Home Purchase Revenue Bonds, 1998 Series A on or about May 5, 1998 (the "1998 Series A Bonds"). The State of California (the "State") will issue Veterans General Obligation Bonds, Series (the "Veterans G.O. Bonds") on or about December 29, 1997 and January 5, 1998. The Bonds, the 1998 Series A Bonds and the Veterans G.O. Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). Applicable Federal tax law establishes certain requirements that must be met subsequent to the respective issuances of the Bonds, the 1998 Series A Bonds, and Veterans G.O. Bonds in order that interest on the Bonds not be included in gross income for Federal income tax purposes under the Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The Department has covenanted in the Resolution to at

all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for Federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenant and have assumed compliance by the Department with and enforcement by the Department of the provisions of the Resolution and the Program Documents. We have also relied upon the approving opinion of Orrick, Herrington & Sutcliffe LLP dated this date with respect to the Veterans G.O. Bonds as to the validity and legality of the Veterans G.O. Bonds and as to exclusion of the interest thereon from gross income of the owners thereof for Federal income tax purposes.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

(i) Pursuant to the Veterans Act, the Department is empowered to issue the Bonds for the purposes specified in the Resolution and to pledge the revenues and amounts in the funds and accounts established by the Resolution.

(ii) The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and represent the legally valid and binding special obligations of the Department, enforceable in accordance with their terms and secured in the manner and to the extent set forth in the Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein.

(iii) The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with its terms.

(iv) The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment of the principal of and interest on the Bonds of (1) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund"), except proceeds of State veterans general obligation bonds (including Veterans G.O. Bonds) and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of general obligation bonds of the Department in the 1943 Fund, created in accordance with any general obligation veterans bond act, (2) any amounts held in the Bond Reserve Account established pursuant to the Resolution, and (3) any amounts held in the Loan Loss Account established pursuant to the Resolution, which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

(v) Under existing statutes and court decisions, (a) interest on the Bonds is not included in gross income for Federal income tax purposes pursuant to Section 103 of the Code, (b) the interest on the 1997 Series A Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Code with respect to individuals and corporations; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations; and (c) interest on the 1997 Series B Bonds and 1997 Series C Bonds is treated as a preference item for purposes of calculating the Federal alternative minimum tax with respect to individuals and corporations. No opinion as to exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Resolution for which action the Resolution requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

(vi) Interest on the Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we are advising you that the enforceability of the Bonds and the Resolution may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We have examined an executed 1997 Series A Bond, 1997 Series B Bond and 1997 Series C Bond and, in our opinion, the forms of said Bonds and their execution are regular and proper.

Very truly yours,

PROPOSED FORM OF OPINION WITH RESPECT TO THE 1998 SERIES A BONDS

[closing date]

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as Attorney General of the State of California and as bond counsel, respectively, and in such capacities we have examined upon request copies of proceedings taken by the Department of Veterans Affairs of the State of California (the "Department") in connection with the issuance of the Department's Home Purchase Revenue Bonds, 1998 Series A (the "Bonds"), in the aggregate principal amount of \$154,065,000, and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), and (4) the Ninth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$294,430,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A, adopted November 24, 1997 and amended December 22, 1997 (the "Ninth Supplemental Resolution"). The Resolution of Issuance, the Eighth Supplemental Resolution and the Ninth Supplemental Resolution, are collectively referred to herein as the "Resolution."

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, are subject to mandatory tender, and are payable as provided in the Resolution. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolution.

The Department issued its Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B and 1997 Series C on _____, 1997 (collectively, the "1997 Revenue Bonds"). In addition, the State of California (the "State") issued Veterans General Obligation Bonds, Series _____ (the "Veterans G.O. Bonds") on or about _____, 1997 and _____, 1998. The Bonds, the 1997 Revenue Bonds and the Veterans G.O. Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). Applicable Federal tax law establishes certain requirements that must be met subsequent to the respective issuances of the Bonds, the 1997 Revenue Bonds, and Veterans G.O. Bonds in order that interest on the Bonds not be included in gross income for Federal income tax purposes under the Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The Department has covenanted in the Resolution to at all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for Federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenant and have assumed compliance by the Department with and enforcement by the Department of the provisions of the Resolution and the Program Documents. We have also relied upon the approving opinions of Orrick, Herrington & Sutcliffe LLP dated _____ and _____ with respect to the Veterans G.O. Bonds as to the validity and legality of the Veterans G.O. Bonds and as to exclusion of the interest thereon from gross income of the owners thereof for Federal income tax purposes.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

(i) Pursuant to the Veterans Act, the Department is empowered to issue the Bonds for the purposes specified in the Resolution and to pledge the revenues and amounts in the funds and accounts established by the Resolution.

(ii) The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and represent the legally valid and binding special obligations of the Department, enforceable in accordance with their terms and secured in the manner and to the extent set forth in the Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein.

(iii) The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with its terms.

(iv) The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment of the principal of, and interest on the Bonds of (1) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund"), except proceeds of State veterans general obligation bonds (including Veterans G.O. Bonds) and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of general obligation bonds of the Department in the 1943 Fund, created in accordance with any general obligation veterans bond act, (2) any amounts held in the Bond Reserve Account established pursuant to the Resolution, and (3) any amounts held in the Loan Loss Account established pursuant to the Resolution, which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

(v) Under existing statutes and court decisions, (a) interest on the Bonds is not included in gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (b) interest on the Bonds is treated as a preference item for purposes of calculating the Federal alternative minimum tax with respect to individuals and corporations. No opinion as to exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Resolution for which action the Resolution requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

(vi) Interest on the Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we are advising you that the enforceability of the Bonds and the Resolution may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We have examined an executed Bond and, in our opinion, the form of said Bond and its execution are regular and proper.

Very truly yours,

(THIS PAGE INTENTIONALLY LEFT BLANK)

Ambac

Municipal Bond Insurance Policy

EXHIBIT F

Ambac Assurance Corporation
c/o CT Corporation Systems
44 East Mifflin Street, Madison, Wisconsin 53703
Administrative Office:
One State Street Plaza, New York, New York 10004
Telephone: (212) 668-0340

Issuer:

Policy Number:

Bonds:

Premium:

Ambac Assurance Corporation (Ambac) A Wisconsin Stock Insurance Company

in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to United States Trust Company of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of Bondholders, that portion of the principal of and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Ambac will make such payments to the Insurance Trustee within one (1) business day following notification to Ambac of Nonpayment. Upon a Bondholder's presentation and surrender to the Insurance Trustee of such unpaid Bonds or appurtenant coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Bonds and coupons and shall be fully subrogated to all of the Bondholder's right to payment.

In cases where the Bonds are issuable only in a form whereby principal is payable to registered Bondholders or their assigns, the Insurance Trustee shall disburse principal to a Bondholder as aforesaid only upon presentation and surrender to the Insurance Trustee of the unpaid Bond, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to the Insurance Trustee, duly executed by the Bondholder or such Bondholder's duly authorized representative, so as to permit ownership of such Bond to be registered in the name of Ambac or its nominee. In cases where the Bonds are issuable only in a form whereby interest is payable to registered Bondholders or their assigns, the Insurance Trustee shall disburse interest to a Bondholder as aforesaid only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Bond and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to the Insurance Trustee, duly executed by the claimant Bondholder or such Bondholder's duly authorized representative, transferring to Ambac all rights under such Bond to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all the Bondholder's rights to payment on registered Bonds to the extent of the insurance disbursements so made.

In the event the trustee or paying agent for the Bonds has notice that any payment of principal of or interest on a Bond which has become Due for Payment and which is made to a Bondholder by or on behalf of the Issuer of the Bonds has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Bondholder" means any person other than the Issuer who, at the time of Nonpayment, is the owner of a Bond or of a coupon appertaining to a Bond. As used herein, "Due for Payment", when referring to the principal of bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all principal of and interest on the Bonds which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Bonds prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President



Secretary

Effective Date:

Authorized Representative

UNITED STATES TRUST COMPANY OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Authorized Officer

(THIS PAGE INTENTIONALLY LEFT BLANK)

(THIS PAGE INTENTIONALLY LEFT BLANK)